

**STREET LIGHTING
PROCUREMENT PACK**

VERSION 4 – March 2008



Street Lighting Procurement Pack - Contents

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Foreword

As at February 2008, the Department for Transport (DfT) has approved Private Finance Initiative (PFI) funding for 35 English local authority street lighting projects, and had allocated new funding of some £1.3 billion for these schemes. Nineteen of these projects are in operation and the remainder are at various stages of procurement and development.

Street lighting is a highly visible, front line, local authority service. Good street lighting provides a vital service during the hours of darkness, protecting people and property, and enhancing the night-time environment (thereby promoting night-time use of local facilities). Effective street lighting deters criminal activity and reduces road accidents. Benefit cost ratios of 5:1 are not uncommon – this means that for every £1 invested in street lighting, £5 can be saved by way of quantifiable reductions in crime and road traffic accidents.

Despite the above, street lighting is a service that is often taken for granted. It is part of the infrastructure of roads, villages, towns and cities. Street lighting enhances life in a way that is only appreciated when it fails, and failure to deliver an adequate service can quickly become a concern to local residents and road users, as is often demonstrated through the feedback to local authorities from customer satisfaction surveys.

There is widespread concern in local authorities regarding the structural condition of the estimated 7.4 million items of street lighting Apparatus in the United Kingdom, and in recent years there have been a number of cases of street lighting columns collapsing, occasionally with fatal results. Various studies have suggested that further investment is required as a matter of urgency, to both remove lighting columns that are dangerous and in need of replacement, and for Apparatus to be replaced by the newer, more energy efficient equipment that is now available.

Using the PFI or a public private partnership (PPP) for street lighting provision allows a local authority to obtain investment by a service provider in better and more efficient Apparatus in order to improve the safety and performance of the street lighting service. The 'spend to save' benefits of this approach, together with the benefits of procuring the whole service rather than the individual components, is demonstrating that procurement through the PFI or a partnership route is a better way to optimise whole-life costs and service delivery.

To date, because of the funding needed to address the backlog of investment, local authorities have sought central government financial support towards the costs of the street lighting projects. However, some local authorities may not have significant investment needs and may therefore be able to afford, using the prudential regime, to procure the service through a PPP or PFI route without central government support in the form of PFI credits.

Given the level of interest in using the PFI and PPP for the street lighting service, this Procurement Pack has been produced for local authorities by the 4ps, Addleshaw Goddard (legal advisors), WSP Group (technical advisors) and PricewaterhouseCoopers (financial advisors). The over-riding objective of the Procurement Pack is to provide the tools necessary for a local authority to procure a street lighting project through a PFI or PPP route as smoothly and speedily as possible. The Procurement Pack aims to reflect emerging good practice from the projects currently in operation or procurement.

Accompanying the guidance, there is model, template, worksheet or example documentation where this is relevant or appropriate. The Models and Worksheets accompanying each Part of this guidance are listed in the Contents, and are available from 4ps. In using the Models and Worksheets contained in the Procurement Pack, local authorities should take care to use and

amend these to ensure that they reflect local circumstances, and take account of the specific aims and objectives of the local authority in the delivery of its street lighting service. Local authorities should be aware, however, that the DfT expects local authorities to comply with the requirements of the Procurement Pack as regards use of the Model Contract in respect of derogations from SoPC.

Local authorities must also assess, as part of the developmental stage, the skills and expertise of the in-house team to develop and deliver the project, and must determine the areas where external technical, financial and legal support will be required. In making this assessment, local authorities should not under-estimate some of the complex issues involved in the procurement of a long-term contractual arrangement through the PFI or a PPP.

4ps, March 2008

Acknowledgments

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The 4ps would also like to thank HM Treasury and Partnerships UK for their assistance and sign-off of the guidance in this Procurement Pack on contractual issues included in Part Six of the Procurement Pack, and the sector specific contract (the Model Contract included in this Procurement Pack).

Disclaimer

This street lighting Guidance has been produced by the 4ps, in consultation with Addleshaw Goddard (legal advisers), WSP Group (technical advisers) and PricewaterhouseCoopers (financial advisers) (together the 'Advisers') to provide assistance to local authorities in the procurement of street lighting projects through a public private partnership or through the Private Finance Initiative. The Guidance has been published in good faith by the 4ps with the help of its Advisers, and neither the 4ps nor its Advisers shall incur any liability for any action or omission arising out of any reliance being placed on the Guidance by any local authority or organisation or other person. Any local authority or organisation or other person in receipt of this Guidance should take their own legal, financial and other relevant professional advice when considering what action (if any) to take in respect of any initiative, proposal, or other involvement with any public private partnership, or before placing any reliance on anything contained therein.

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Purpose and Structure of 4ps Procurement Packs

The over-riding objective of the 4ps Procurement Packs is to provide the tools necessary for a local authority to procure a service or project in the service area through a PFI or PPP route as smoothly and speedily as possible. The Procurement Packs reflect emerging good practice from local authority PFI and PPP schemes, in both the service area and more widely, that are currently in operation or procurement.

Part 1 of the Procurement Pack covers the strategic context and identification of need for change in the service, resulting from the development of the service area strategy, or as a result of actions arising from the CPA process, a Best Value Review, or from work undertaken as part of an efficiency review. Part 2 provides guidance on project management and project governance issues for the successful delivery of projects. Part 3 covers the developmental stage, providing guidance on the evaluation of project and procurement options and the development of an Outline Business Case, and includes the departmental assessment criteria for projects in the service area where central government support is being sought. Part 4 explains the purpose of an Output Specification and its key features, with Part 5 explaining the development of the Payment Mechanism for a scheme in the service area, and Part 6 providing guidance on the development of the Model Contract for the project. Part 7 covers the pre-qualification stage. Part 8 provides guidance on the Competitive Dialogue, with Part 9 addressing the issues involved in the selection of a Preferred Bidder. Part 10 provides guidance on the issues involved in completion and reaching Contract and financial close. Appendix One lists other relevant guidance material, and Appendix Two includes a copy of relevant case studies.

Accompanying the guidance, there is model, template, worksheet or example documentation where this is relevant or appropriate. The Models and Worksheets accompanying each Part of this guidance are listed in the Contents.

This guidance is generally intended to provide assistance in the procurement of a scheme in the service areas through a PPP or PFI route. Whilst the guidance should make the procurement of PFI and PPP projects easier, it should be used to *inform* the procurement process rather than be regarded as purely prescriptive. In using the Models and Worksheets contained in the Procurement Pack, local authorities should take care to use and amend these to ensure that they reflect local circumstances, and take account of the specific aims and objectives of the local authority in the delivery of its service. However, local authorities should be aware that HM Treasury and the relevant sponsoring department expect local authorities to comply with the requirements of the Procurement Pack as regards use of the Model Contract and derogations from SoPC.

Local authorities must also assess, as part of the developmental stage, the skills and expertise of the in-house team to develop and deliver the project, and must determine the areas where external technical, financial and legal support will be required. In making this assessment, local authorities should not under-estimate some of the complex issues involved in the procurement of a long-term contractual arrangement through the PFI or a PPP. The procurement process is likely to take between 18 and 24 months, from approval of the proposals (by members, and PRG if the local authority is seeking central government support towards the costs of the project) to contract signature. However, as more schemes have been completed, and more use is made of 4ps Procurement Packs, these timescales continue to be reduced.

Microsoft Word versions of the Model Documentation, and a Microsoft Excel version of the Worksheets included in this Procurement Pack, are available from the 4ps (www.4ps.gov.uk).

The Private Finance Initiative and Public Private Partnerships

A public private partnership is a broad term that encompasses a number of partnership options for service delivery. The PFI is one form of public private partnership, and is particularly relevant for capital-intensive services. The PFI transforms local authorities from being the owners and operators of assets, to the purchasers of services. In a PFI transaction, a private sector service provider is given responsibility for designing, building, financing and operating assets, from which a public service is delivered to agreed standards and subject to a performance-related payment mechanism.

Using the PFI, local authorities and their communities can achieve long-term benefits from private sector expertise and investment in the delivery of public facilities and services. Local authorities are also eligible to seek central government support (in the form of PFI Credits) towards the costs of the PFI project, provided that the project satisfies Department for Communities and Local Government (DCLG), departmental and the Project Review Group (PRG) criteria.

The overriding objective of the PFI is to create a structure in which value for money is optimised, through private sector innovation and management skills; through the synergies from linking design, build and operate; through re-engineering; through the efficient allocation of risk; and through the whole-life and whole-service approach to service delivery.

4ps reviews of operational PFI schemes are indicating that this procurement option can achieve significant benefits, and can clearly repay the effort required. With a PFI, the consideration of operational issues and whole service/whole life implications from the outset as part of the investment decision should contribute to the long-term success of a project, and optimise Best Value over the long-term.

To local authorities considering the Private Finance Initiative (PFI) for the first time, the PFI development and procurement process can appear daunting. To assist users of this Procurement Pack, 4ps have produced a summary of the PFI process – *A Map of the PFI Process* – to provide an overview of the process as a whole, including a short introduction to each of the stages and how they fit together. A copy of the map paper can be downloaded from the 4ps website, www.4ps.gov.uk

Abbreviations and Terminology

The following abbreviations and terminology have been used throughout this Procurement Pack:

Abbreviations

4ps	Public Private Partnerships Programme
ASB	Accounting Standards Board
AST	Appraisal Summary Table (required as part of GOMMS)
BCR	Benefit Cost Ratio
BVPI	Best Value Performance Indicator
CDM	Health and Safety (Construction, Design and Management) Regulations
CPA	Comprehensive Performance Assessment
DBFO	Design, Build, Finance and Operate
DCLG	Department for Communities and Local Government
DfT	Department for Transport
DSO	Direct Service Organisation (or Direct Labour Organisation)
FBC	Final Business Case
FRS5	Financial Reporting Standard 5 – Reporting the Substance of Transactions
GOL	Government Office London
ICT	Information and Communications Technology
ILE	Institute of Lighting Engineers
IRR	Internal Rate of Return
ISDS	Invitation to Submit Detailed Solutions
ISOS	Invitation to Submit Outline Solutions
ISRS	Invitation to Submit Refined Solutions
LPI	Local Performance Indicator
LTP	local Transport Plan
NPV	Net Present Value
OBC	Outline Business Case
OJEU	Official Journal of the European Union
OGC	Office of Government Commerce
PFI	Private Finance Initiative
PIN	Prior Information Notice
PPP	Public Private Partnership
PQQ	Pre-Qualification Questionnaire
PRG	Project Review Group
PSC	Public Sector Comparator
RNF	Relative Needs Formulae
SoPC	Standardisation of PFI Contracts
SPV	Special Purpose Vehicle
TUPE	Transfer of Undertakings (Protection of Employment) Regulations 1981
VFM	Value for Money

Terminology

Apparatus – means all types of street lighting equipment and infrastructure used in the delivery of the street lighting service, including lighting columns, luminaires, control gear, lamps and associated cabling.

Bidder – a candidate, consortium, contractor, private sector partner, SPV or tenderer bidding for the project.

Contract – the Contract or Project Agreement between the parties for the provision of the contracted service.

Descriptive Document – the Descriptive Document, Information Pack, or Information Memorandum issued to Bidders expressing an interest in the project in response to the OJEU Notice.

Local Authority – any City Council, County Council, Borough Council, Unitary Authority or County Borough Council.

Method Statement – any method statement or service delivery plan submitted by a Bidder detailing how an aspect of the service will be delivered.

Procurement Regulations – the statutes, regulations and legislative requirements concerning the procurement of public works, supplies or services.

Public Private Partnership – a range of partnerships, including PFI transactions; design, build finance and operate schemes; and strategic partnerships such as LIFT and BSF.

Street Lighting – has been assumed to include all public lighting and illuminated street Apparatus.

Service Provider – the concessionaire, consortium, contractor, private sector partner or SPV appointed to deliver the contracted services.

Unitary Charge – the payment made by the local authority to the Service Provider for the provision of the contracted service.

**STREET LIGHTING
PROCUREMENT PACK
PART ONE
STRATEGIC CONTEXT**

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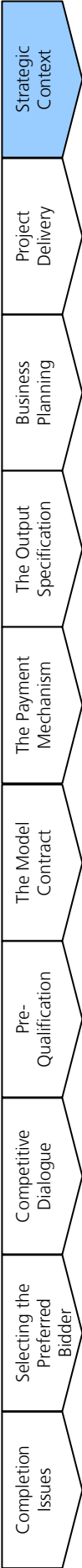
Section 1
Strategic Development of Projects

Section 2
Developing Outcomes, Outputs and Performance Standards

Section 3
Strategic Assessment of Project and Procurement Options

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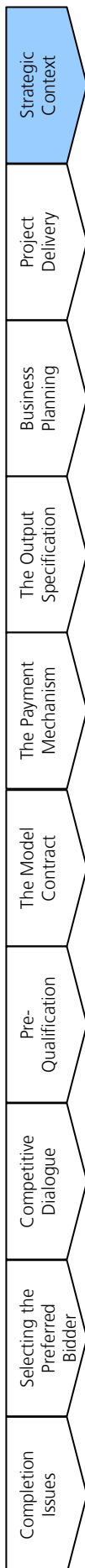


Section 1 Strategic Development of Projects

- 1 All local authority services and projects should be developed, and continually assessed, within the context of the local authority's overall strategic planning framework. Individual projects should be identified, and be developed as part of the local authority's corporate plan and the plans and strategies for the service.
- 2 As part of the local authority's strategic analysis, it will be useful to draw upon evidence of public perceptions of the service. The assessment should show how these perceptions have developed over time and how they reflect demand for better quality or more efficient services. Where there is recent, available analysis of direct contact enquiries or public and community opinion surveys on trends in relation to the performance of the service, this should be included in support of the need for development or improvement in service provision.
- 3 The strategic assessment should also set out the impact or contribution of the project to existing partnership arrangements and other stakeholders of the service. Where there is partnership working or forums for working with the emergency services, development agencies or other relevant organisations, these should be identified and the partners consulted as part of the strategic assessment.
- 4 The strategic assessment should set out how the conclusions are to be taken forward, and how a more detailed investment options appraisal will be undertaken.

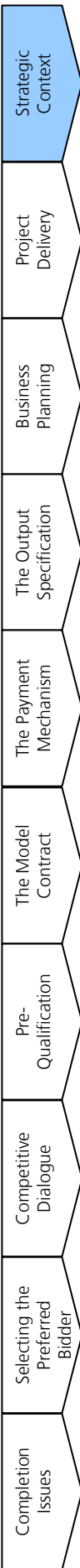
Comprehensive Performance Assessment, Best Value and Efficiency Review

- 5 The legislative framework requires local authorities to make arrangements to secure continuous improvement in the provision of public services and in the way that they carry out their functions, striking the best possible balance between effectiveness, efficiency and economy. Crucial to the strategic assessment will be the conclusions from the CPA, the most recent Best Value Review, and the Efficiency Review work that the local authority is undertaking.
- 6 The Best Value requirements on local authorities fall under the following key headings:
 - **Best Value Reviews and Best Value Performance Plans** – local authorities are required to undertake reviews of all of their functions and to produce an annual Best Value Performance Plan for each function
 - **Consultation** – local authorities are required to consult taxpayers, service users, service providers and the wider business community when carrying out Best Value Reviews. It is up to each local authority to determine how best to undertake this consultation
 - **Best Value Performance Indicators** – the DCLG and the Audit Commission have published a series of Best Value Performance Indicators (BVPIs) for local government services. These BVPIs enable comparisons to be made both with the performance of other local authorities, and with service performance in previous years. In addition, local authorities are being encouraged to develop and use Local Performance Indicators (LPIs) that reflect local priorities and tailor Best Value to suit local circumstances



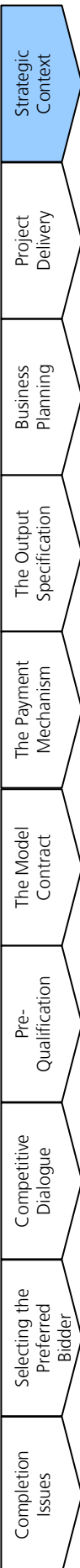
- **Inspection** – all functions may be subject to inspection under Best Value. These inspections will take as a starting point the local authority’s own assessment of its performance, and any action it plans to take to improve service delivery.

- 7 It is important that any service or project, and its documentation, are developed in the context of the local authority’s CPA, Best Value framework, and Efficiency Review work. Development of a project should flow from the conclusions of a Best Value Review, Efficiency Review or strategic service review.
- 8 Local authorities are expected to undertake regular surveys of user satisfaction with relevant stakeholders in the service or project, and the feedback from users should be taken into account in future Best Value Reviews and in preparing the annual Best Value Performance Plan.
- 9 The 4ps have produced a local government supplement to the guidance *Standardisation of PFI Contracts* that includes specific guidance on Best Value issues and suggested contract drafting on the Best Value requirements. This guidance is available from the 4ps. The required drafting has been incorporated in to the Model Output Specification, Payment Mechanism, and Contract included in this Procurement Pack.

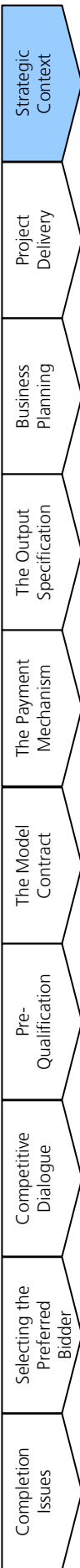


Section 2 Developing Outcomes, Outputs and Performance Standards

- 10 If a strategic review has demonstrated that a PFI or PPP is potentially an appropriate procurement route for delivering a service or project, the next stage should be to investigate fully the project options and procurement options available and the results documented in an Outline Business Case (OBC). The decision to procure the service through a particular service delivery route should be fully supported by a comprehensive review of the options available.
- 11 Section 3 of this Part of the Procurement Pack outlines the project and procurement (or service delivery) options for the service area.
- 12 Some departments have introduced a bidding process for local authority PFI projects. Where departments have bidding rounds in place, the local authority will need to prepare an expression of interest; this is effectively a strategic version of the OBC but produced in advance of some of the detailed business planning work having been undertaken. 4ps believes however that the principles of good business planning **must** be used in developing an expression of interest as part of a departmental bidding round, and that the expression of interest should be viewed as a 'mini' or 'strategic' version of the OBC. Adopting such an approach will also make it easier to convert the expression of interest to an OBC should the local authority successfully secure funding as part of the bidding round.
- 13 In order that the appraisal of project and procurement options is done on a like-for-like basis, the local authority will need to give some preliminary thought to the project outcomes, outputs and performance standards that are to be used for the service.
- 14 Parts Four and Five of this Procurement Pack set out the arrangements for developing the performance standards for inclusion in the Output Specification and Payment Mechanism for the project. In developing the performance standards, the local authority should take account of the BVPIs and any LPIs for the service, and the targets included in the service strategy and CPA.
- 15 Whilst the BVPIs should not distort the need for the Output Specification and Payment Mechanism to reflect the service and project-specific objectives of the local authority and other stakeholders involved in the service, it is important that in developing the performance standards, appropriate consideration is given to these indicators. BVPIs are key indicators against which a local authority should be measuring service delivery, and wherever appropriate BVPIs and LPIs should be incorporated directly as contractual outputs, with the attainment of the performance standard having a direct impact through the Payment Mechanism.
- ### Incentivising the Service Provider
- 16 The local authority will need to ensure that arrangements are in place to facilitate reporting against the relevant BVPIs and LPIs, or any performance indicators developed as part of the service strategy or CPA. If any aspect of the service is being delivered through a PFI/PPP Contract, it is important that there is a contractual obligation on the service provider to assist the local authority compute and report its performance against the relevant performance indicators.

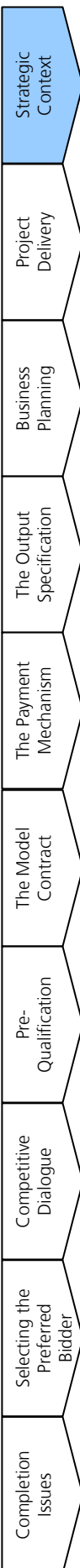


- 17 The service provider should also be obliged to work with and assist the local authority with the development of future service strategies, CPA, Best Value Reviews, completing the annual Best Value Performance Plan, future Efficiency Reviews, any audits and inspections and, where appropriate how the views of users and stakeholders should be taken into account in the provision of the contracted services.
- 18 4ps Transport Team suggest that local authorities include these requirements for assistance and reporting as part of the Output Specification, and require bidders to submit a Method Statement setting out their proposals for assisting the local authority to meet, and continue to meet, its responsibilities in relation to the service strategy, CPA and Best Value regimes. Bidder responses on this strategic assistance and reporting should be an important part of the evaluation process. 4ps also suggest that local authorities consider incorporating the strategic assistance and reporting requirements as a performance standard, ideally linked to the Payment Mechanism so that part of the unitary charge is put at risk for unsatisfactory completion of the assistance agreed as part of the Contract negotiations.
- 19 The model Output Specification and model Payment Mechanism included in this Procurement Pack include a performance standard for strategic assistance and reporting.



Section 3 Strategic Assessment of Project and Procurement Options

- 20 The strategic analysis should examine the relationship between the local authority's vision and objectives of the street lighting service, and the corporate plan and objectives of the local authority. Typically this will cover the transportation, environmental and regeneration/social objectives included within a range of statutory plans and other local authority policies, including those contained within:
- The local Transport Plan (LTP).
 - The Comprehensive Performance Assessment (CPA).
 - The Best Value Performance Plan (or conclusions from the latest Best Value Review).
 - Environmental strategies and policies.
 - Area regeneration and community safety initiatives, and other community strategies or plans.
- 21 As part of the strategic analysis it will be useful to draw upon any evidence of public perceptions of the street lighting service. The assessment should show how these perceptions have developed over time and how they reflect demand for better quality or more efficient services. Where there is recent, available analysis of public and community opinion surveys on trends in relation to the performance of the street lighting service, this should be included in support of the need for development or improvement in service provision.
- 22 It may also be useful to provide analysis of the public's interaction with the service through:
- The results of the LTP and/or Best Value consultation processes in relation to the street lighting service.
 - Analysis of the numbers and frequency of requests for service and/or complaints.
 - Analysis of the requests for improved street lighting.
 - The results of other surveys/initiatives where improvements to the lighting service have been cited as a means of improving the effectiveness of other local authority activities (for example safer routes to schools, area community safety/regeneration initiatives and redevelopment proposals).
- 23 The strategic assessment should set out the impact or contribution of the project on existing partnership arrangements and other stakeholders of the service. Where there is partnership working or forums for working with the emergency services, development agencies or other relevant organisations, these should be identified and the partners consulted as part of the strategic assessment.
- 24 The strategic assessment should set out how the conclusions are to be taken forward and how a more detailed investment options appraisal will be undertaken.



**STREET LIGHTING
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PART TWO
PROJECT DELIVERY**

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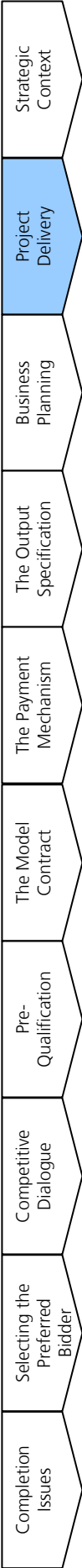
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Communications Strategy and Stakeholder Management

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Also relevant to this Part Two of the guidance is:

- **Worksheet 1 – Procurement Timetable**



Section 1 Project Management and Governance

25 This Part of the Procurement Pack provides guidance on developing the project management arrangements to deliver a PFI/PPP project. Although aimed primarily at what is required following approval to procure the project, some preliminary thought will need to be given to the project management arrangements before then since details of how the project will be delivered will need to be included in the OBC. Project management arrangements will also need to be in place for developing the OBC itself.

26 4ps have produced a *Guide for Project Directors and Project Owners* that provides more detailed guidance and actions necessary on this aspect for the successful development and procurement of PFI and PPP projects. This guidance should not be copied word for word in Expressions of Interest and Outline Business Cases; local authorities should use this as guidance and develop appropriate wording to suit local circumstances and arrangements. Local authorities may also wish to refer to guidance on project management produced by the APM.

Overall Arrangements for Project Management

27 The arrangements put in place for project management should reflect the specific needs of the local authority, and the size and complexity of the scheme. The arrangements should also be developed to fit with the existing decision-making structures of the local authority.

28 Good project management is key to the success of any major procurement; 4ps experience suggests that effective project management should incorporate the following principles:

- A Project Director needs to be 'empowered to do the deal'
- Roles and responsibilities are defined and agreed so that everyone involved knows what they have to do and by when
- The stages of the procurement process are set out with clear milestones and expectations of what is to be done at each stage in the process
- People with appropriate skills and experience are assigned to project roles
- Resources and timescales are determined at the outset
- Risks associated with the project are properly identified and managed
- Stakeholders are engaged and kept informed.

29 Whilst it is up to the individual local authority to determine the most appropriate structure for the development and procurement of its service or project, this guidance aims to highlight the key issues which should be considered. Figure 2.1.1 summarises the typical structure for project delivery.

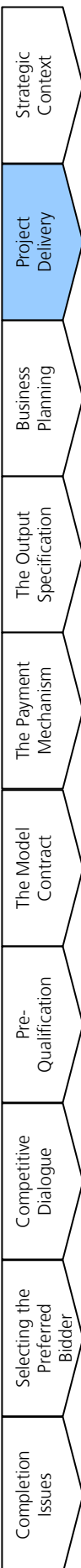
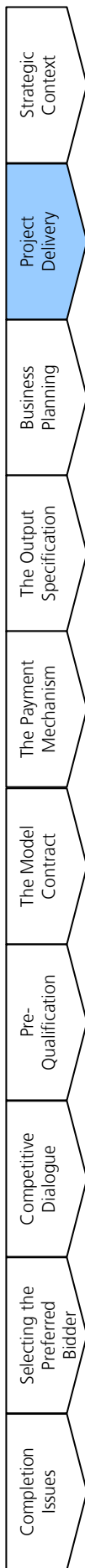
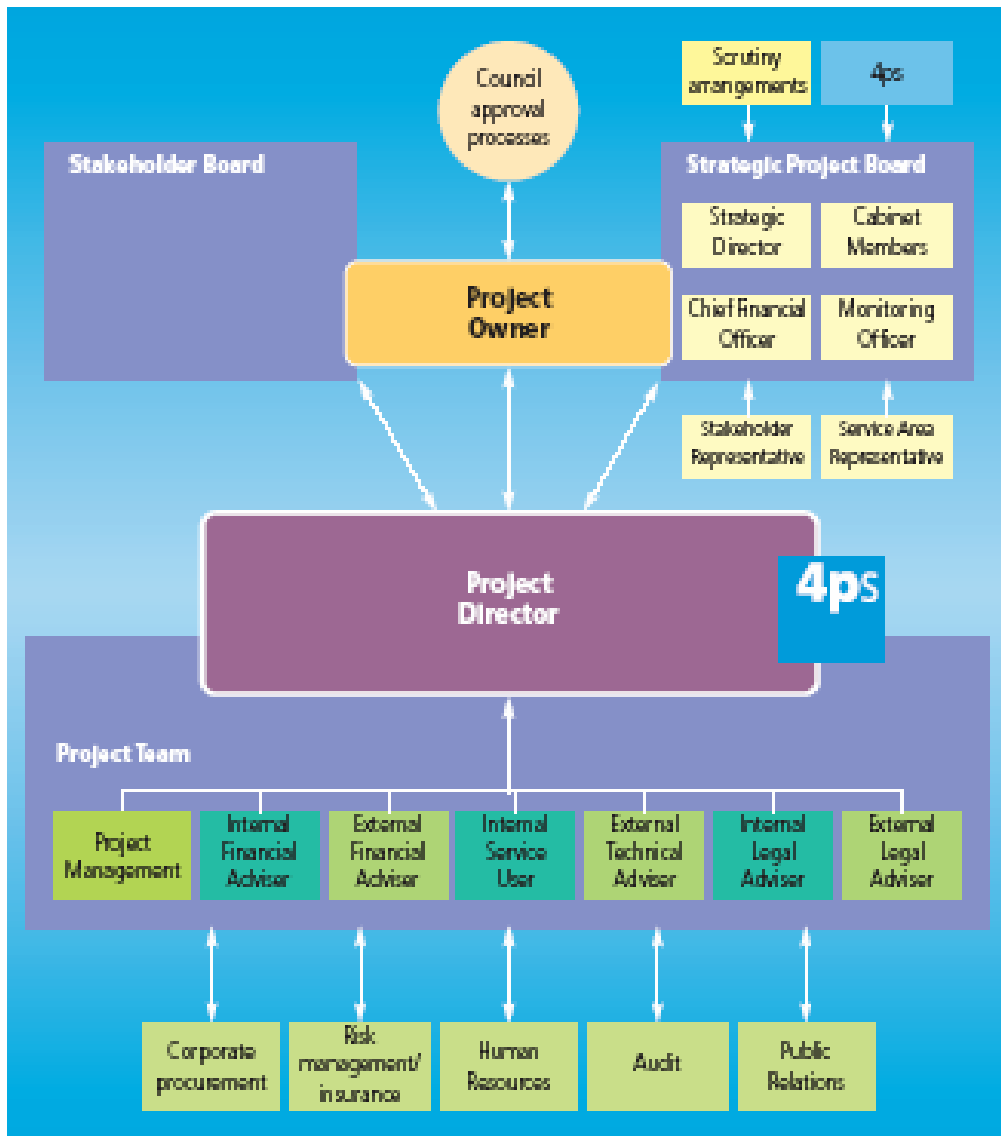


Figure 2.1.1 – Project Delivery Arrangements



Project Director

- 30 This is arguably the most significant appointment, and it is important that the project director has, or is delegated the necessary decision-making authority, and is 'empowered to do the deal'. The level of seniority of the officer should therefore depend on the local authority's ability to delegate responsibility and authority to the project director to 'do the deal', and this will reflect the size, complexity, risk and profile of the scheme, and the local authority's decision-making structures.
- 31 The project director will be responsible for directing, leading and managing the project team, and must have sufficient time to deliver the project (in terms of both being freed from other responsibilities and through the development of a realistic project plan), recognising the complexities and time-consuming nature of many aspects of a procurement through the PFI or a PPP.

32 As many PFI and PPP projects involve staff from a range of disciplines, project directors will be directing staff for whom they do not have day-to-day management responsibility. It is important therefore that the project director is given appropriate support from the chief officers of these other disciplines.

Project Team

33 A team that has the relevant skills and experience to deliver the project should support the project director. It is normal for the team to include project management, technical (service), financial and legal officers, and possibly the local authority's procurement officer and risk management officer. Ideally the aim should be to keep the project team to about eight to ten individuals to ensure that the whole procurement process can be kept manageable, although some projects may require more input, particularly at various times of the procurement. Once the project team is assembled, roles should be clarified and responsibilities allocated.

34 For many projects (and probably all PFI and PPP schemes) it is likely that the local authority will require external support to complement the skills and experience of in-house staff. The extent of such support will depend on the type, size and complexity of the project, the skills and experience of in-house staff, and the internal resources available. A 4ps Transport Executive has been a member of the project team on a number of local authority PFI/PPP projects, actively involved in all aspects of the procurement. Local authorities can discuss the opportunities for this with 4ps Transport Team.

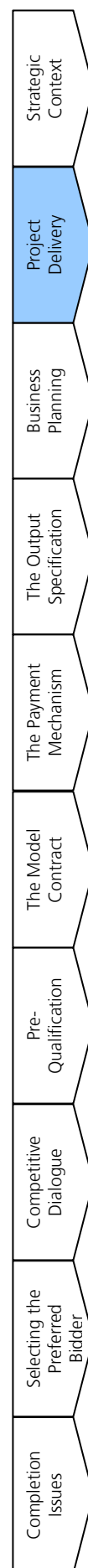
35 Local authorities should not underestimate the level of resources required to deliver PFI projects, and the project director should ensure that the project team has the skills and experience to match those of the likely bidders and their advisors. If necessary, training should be arranged for in-house staff at an early stage in the procurement process. 4ps offers local authorities opportunities for such training.

36 For PFI/PPP projects it is likely that external support will be necessary on areas like financial modelling, development of the Output Specification and Payment Mechanism, development of the Contract and for the evaluation and negotiation of complex financing and contractual issues. Care should be taken to appoint external advisors with the skills and experience to complement the capability of the in-house team, and with the necessary resources to meet the project requirements. 4ps Transport Team is able to provide valuable advice on the likely budget requirements for such external assistance.

37 A formal procurement process is likely to be needed for all external advisors. If the costs of the external advisors are expected to exceed the EU procurement thresholds, the local authority must ensure that the appropriate procedure is followed in the procurement and appointment of those advisors. 4ps Transport Team is available to discuss with local authorities the roles and arrangements for such appointments.

Project Owner

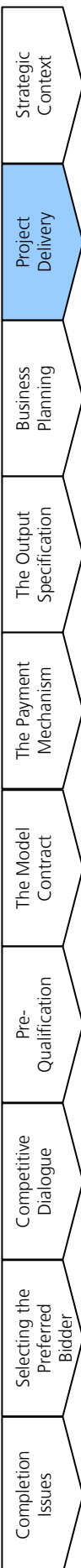
38 Each project should have a project owner – ideally this should be the Director or Assistant Director with overall responsibility for the service. Local authorities procuring the larger and higher-risk projects might consider appointing the Chief Executive or Executive Member as the project owner.



- 39 The project owner will have overall responsibility for a successful outcome, and should be someone that can broker relationships with external stakeholders, and have a good understanding of the business issues associated with the project. The project owner will need to be in a position to take decisions on key issues as they arise, and should be able to access resources outside the control of the project team.
- 40 The project owner should generally support the project director, be involved in key 'competitive dialogue' meetings, and generally be responsible for promoting the project with members, stakeholders and other external bodies. Local authorities should make clear to bidders the respective roles of the project director and project owner.

Approval and Governance Arrangements

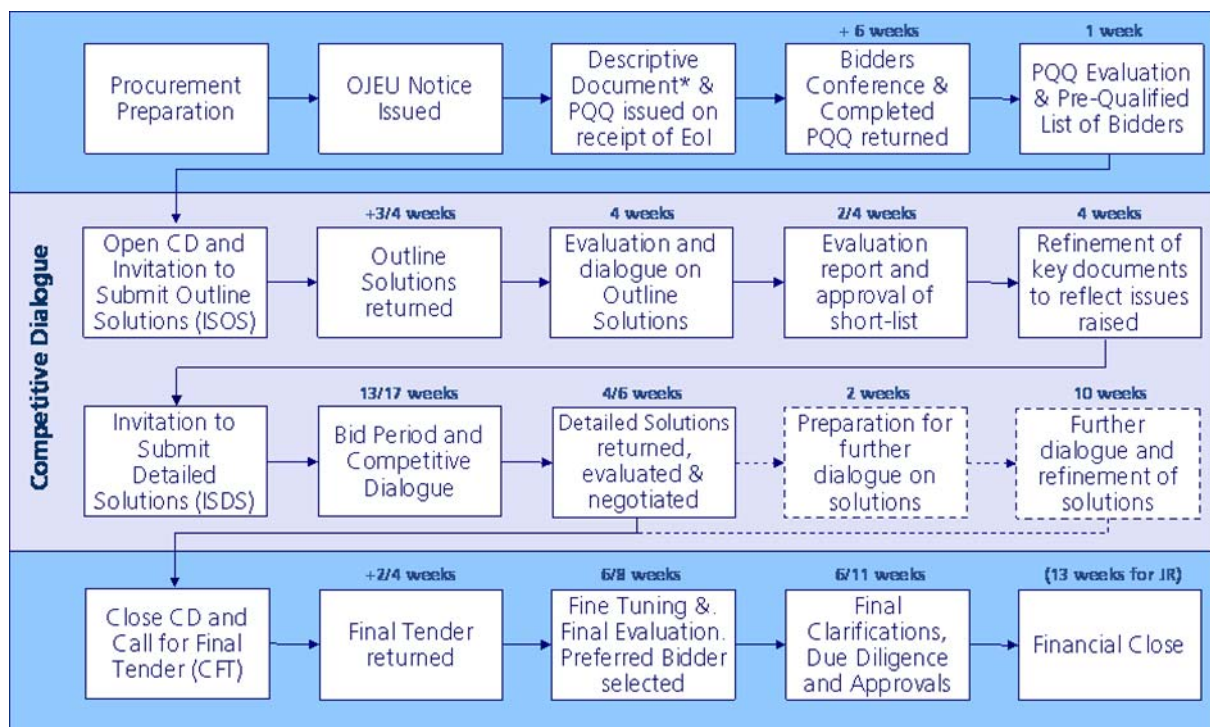
- 41 A strategic project board should be set up and used as a means of seeking ratification from members, chief officers and stakeholders (as appropriate) of decisions taken by the project team; to generally provide support for the project in the wider strategic context; to review and approve the key project documentation; and to sign off key stages of the project, such as selection of the short-list after the initial competitive dialogue stage, selection of the preferred bidder and approval of the Final Business Case. Member support for the project is imperative if the project is to be developed and procured smoothly.
- 42 For more complex projects, or those involving a range of stakeholders or more than one local authority, a stakeholder board should also be put in place to manage stakeholder engagement and 'buy-in' to the project, and ensure that the service being specified meets the needs and requirements of the key stakeholders. The project owner should chair the stakeholder board and the project director should provide the link to the delivery vehicle - the project team.
- 43 For the single local authority projects, local authorities should consider if a well-thought-out project team, with a strong project owner and project director, and clear member and chief officer reporting and decision-making arrangements (ideally with the approval and governance arrangements managed through a strategic project board), is more appropriate than a stakeholder board for the efficient and speedy delivery of the project.
- 44 For joint local authority projects, it is important that the stakeholder board clarifies the roles and responsibilities of each of the participating local authorities, and that it is made clear who is to do what and when, and who is to pay for what and when.



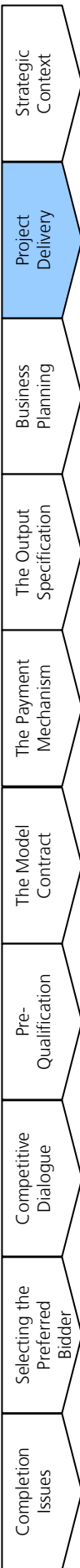
Section 2 Procurement Timetable

- 45 Once assembled, an initial task of the project team should be to develop the timetable for the procurement of the project that fits with the in-house skills and experience, the relevant decision-making structures, and the experience and role expected of the external advisors. All members of the project team (and other stakeholders where appropriate) should be signed up to the delivery of the project to the timetable agreed.
- 46 In developing the procurement timetable, the project director and project team will need to determine an initial view of the approach to be adopted at the various stages of competitive dialogue, and how the employee representatives will be consulted at key stages in the procurement process.
- 47 Thorough preparation for the procurement of a project will pay dividends; it will minimise the scope for misunderstandings in the procurement process and provide confidence to bidders as to what is expected at each stage of the competitive dialogue process. Sufficient attention should be given to the development of the procurement timetable to ensure that key tasks are identified, and sufficient time allowed for those tasks to be completed.
- 48 A model procurement timetable has been developed as part of this Procurement Pack (Worksheet 1 – Project Timetable). The model includes indicative time periods for each stage of a typical procurement. This timetable is considered to be achievable, but at the same time will require strong project management arrangements to be put in place. A summary of the timetable is shown at Figure 2.2.1

Figure 2.2.1 – Overview of the Procurement Process

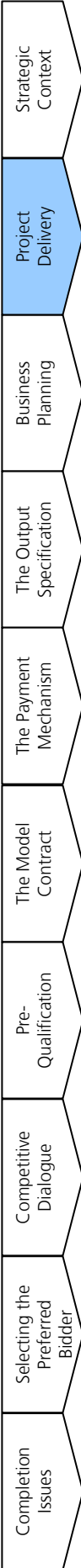


49 It is considered that a comprehensive step-by-step timetable with key tasks and responsibilities allocated is the most suitable approach. However, local authorities may wish to use gantt charts or other project management software (such as PRINCE).



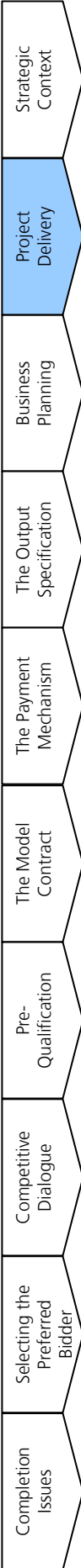
Section 3 Appointment and Management of Advisors

- 50 *4ps Guide for Project Directors and Project Owners* provides some commentary on the potential roles and responsibilities of advisors, together with some key aspects for managing advisors.
- 51 Additional guidance on the appointment and management of advisors is also available from 4ps website.

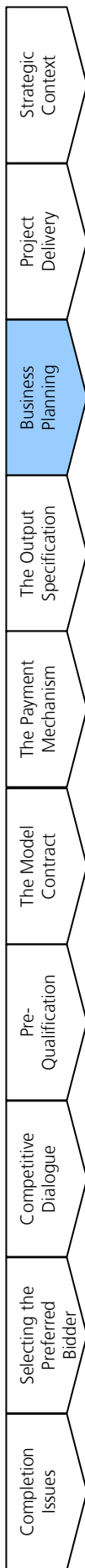


Section 4 Communications Strategy and Stakeholder Management

52 [To be completed]



**STREET LIGHTING
PROCUREMENT PACK
PART THREE
BUSINESS PLANNING**



Contents – Part Three – Business Planning

Section 1
Developing the Outline Business Case and Expression of Interest

Section 2
Key Issues for a Street Lighting Project

Section 3
Benefits Appraisal

Section 4
Developing the Financial Models for the OBC

Section 5
Calculating the PFI Credit for a Street Lighting Scheme

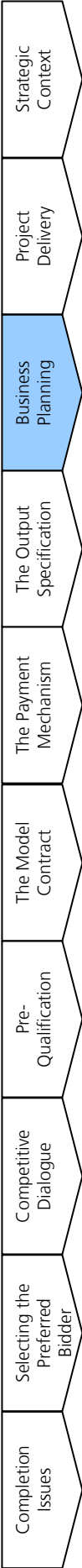
Section 6
The Risk Register

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Also relevant to this Part Three of the guidance is:

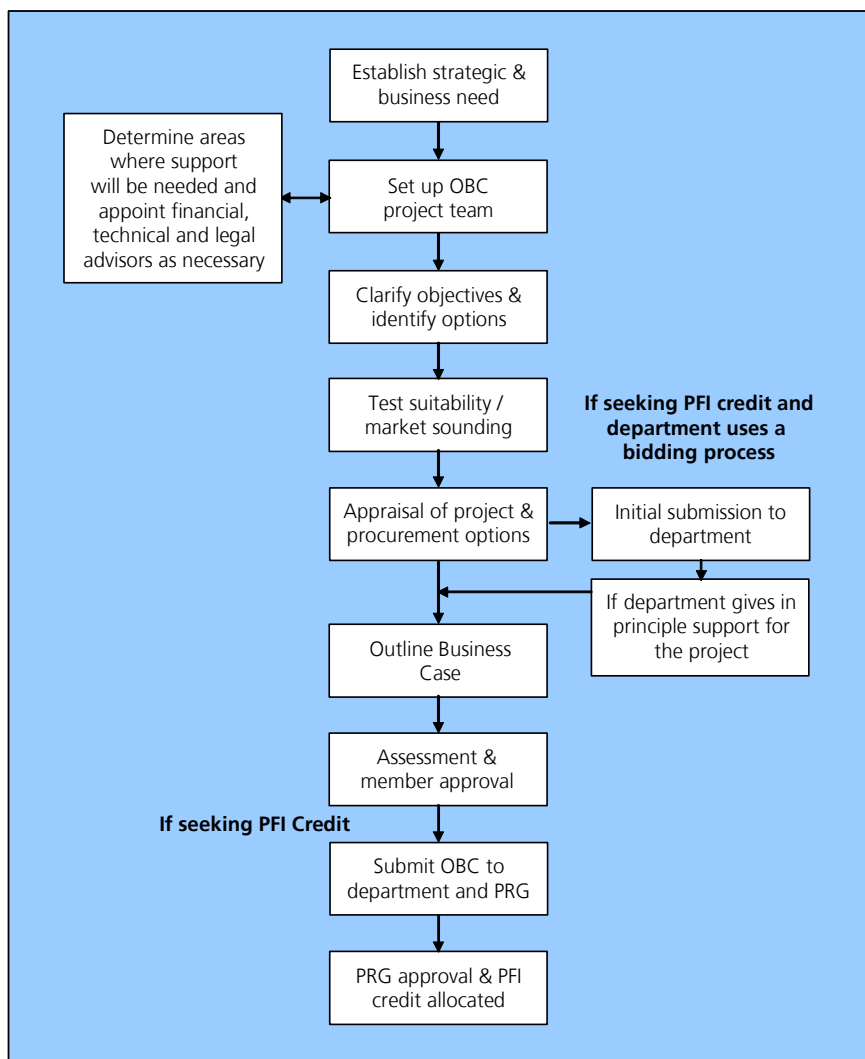
- **Worksheet 2 – Benefits Worksheet**
- **Worksheet 3 – OBC Financial Model Template**
- **Worksheet 4 – Calculation of PFI Credit**
- **Worksheet 5 – Risk Register**



Section 1 Developing the Outline Business Case

- 53 Once the need for the project has been identified, the next stage should be to investigate fully the project options and procurement options for delivering the service, involving a robust strategic and financial analysis of the options available. The results of this appraisal, including conclusions supporting the choice of service delivery route, should be fully documented in an Outline Business Case (OBC). The OBC is an integral part of the decision-making process, and should include all the necessary information and analysis required by the local authority and/or central government sponsoring department, to decide if the project should proceed as planned.
- 54 This section of the Procurement Pack provides guidance on developing the OBC for a PFI/PPP scheme, with sections 2 through to 6 providing more detailed guidance on specific components of the OBC. The outline structure for the OBC offered in this guidance is based upon successful business cases and best business planning practice.
- 55 A summary of the approach leading to the development of the OBC is shown in figure 3.1.1.

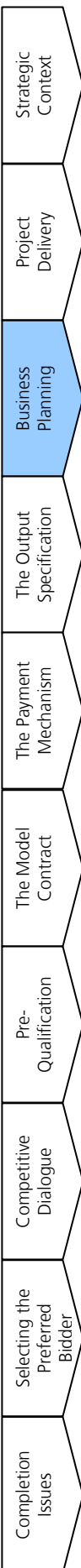
Figure 3.1.1 – Developing the Outline Business Case



- 56 The OBC establishes the initial feasibility of a suitable procurement route for the project, and sets the key parameters and milestones for managing and tracking progress, and for taking the project forward in a way that focuses on achieving the objectives and outputs required. The OBC needs to be a realistic assessment of what is possible, not a list of impractical proposals. It should not be seen as a 'hurdle' to pass, such as part of the case for seeking central government financial support towards the costs of a project, but rather a document that justifies to the decision makers that there is a sound business case for proceeding with the chosen project and procurement option; that it best meets the local authority's objectives and requirements at an affordable cost; that the project is sound in economic terms; and that the preferred option represents value for money. How a local authority has arrived at a particular option will also be important information for the subsequent competitive process.
- 57 Where central government financial support towards the costs of the project (in the form of a PFI credit) is being sought, a copy of the OBC will be required by the relevant department. Many sponsoring central government departments have specific criteria; these are reproduced in Sections 3 and 5 of this Part of this Procurement Pack. The departmental guidance explains how the department will review and assess the proposed project against departmental policies and priorities, and how it will assess the extent of central government support for the project.
- 58 Some central government departments have introduced a bidding process for local authority projects which enables local authorities, before undertaking the detailed work on the OBC, to obtain an early indication of whether the project will be supported financially. This indication will be made on the basis of an 'expression of interest' submitted by the local authority so it is important that sufficient work is done at the initial stage on the assessment of project and procurement options to ensure that costs and affordability are fully assessed for inclusion in this document. In terms of assessing costs and scope, the work for an expression of interest should be done to the same level of detail as is required for the OBC if the bid for PFI funding is to be accurate. Information on the latest bidding rounds can be obtained from 4ps Transport Team or the relevant department.
- 59 4ps believes that the principles of good business planning must be used in developing the expression of interest as part of a departmental bidding round, and that the expression of interest should be viewed as a 'mini' or 'strategic' version of the OBC. Adopting such an approach will also make it easier to convert the expression of interest to an OBC should the local authority successfully secure funding as part of the bidding round.
- 60 Sponsoring departments will forward the projects they wish to support to the Project Review Group (PRG) for the review of project 'deliverability'. Projects satisfying both the departmental and PRG criteria will be awarded a PFI credit, and the approval of the project will be published. This process gives explicit indication to potential bidders that the project meets the departmental and PRG criteria, including, importantly, that the PFI Reference Project set out in the OBC has been independently assessed as being affordable. The development of the Reference Project is discussed further below.

Managing the Business Case Process – OBC Project Team

- 61 A critical factor in the efficient and successful development of major projects is establishing robust project management arrangements, guidance for which is given in Part Two of this Procurement Pack. The advice given there applies also to project management arrangements that should be put in place to develop and deliver the OBC in accordance with the timetable agreed as part of the strategic service review.



- 62 The team appointed to develop the OBC is likely to be the very similar to that appointed to develop the project itself. Responsibilities for carrying out the business planning work need to be well defined. Day-to-day responsibility for the delivery of the OBC should rest with a project director, supported by a small project team with the relevant skills and expertise to carry out expertise to carry out the options appraisal process, development of financial models, and assessment of costs, benefits and risks. If the necessary skills and expertise for developing the OBC are not available in-house, the local authority will need to consider the appointment of financial and/or technical advisors to support and assist with the development of the OBC. The 4ps Transport Team can provide further guidance and assistance to local authorities on the appointment and role of external advisors.
- 63 The participation of the relevant managers, staff, users and other stakeholders in the preparation of the OBC will be essential for a successful outcome. Local authorities should involve those stakeholders who have a direct interest in the project, and the impact it will have. Gaining their understanding and commitment at an early stage will help to secure the changes and benefits the project is intended to deliver.

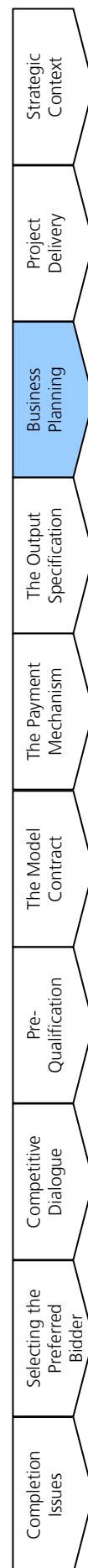
Project Scope

- 64 The careful definition of the scope of services to be provided is one of the first tasks in developing an OBC, and it is vital in enabling sound judgments to be made about costs, risks and the benefits of different project and service delivery options. The scope of the project is an issue for each local authority and will depend upon local organisational and service delivery issues, and the results of the strategic service review, CPA or Best Value review. If a local authority has secured provisional approval for a project through a departmental bidding round, the OBC might also highlight any departures from the scheme provisionally approved.

Components of the Outline Business Case

- 65 The OBC should be supported by a robust reporting structure and format that provides a structured and systematic approach to analysing the current service, setting out the evaluation criteria, examining the different project and procurement options, identifying the Best Value solution and considering key implementation issues. This section of the Procurement Pack includes a suggested reporting structure for a PFI/PPP OBC. The key elements of this are illustrated in figure 3.1.2, with guidance for each element given in the paragraphs that follow.

Figure 3.1.2 – Key Elements of the OBC



Executive Summary of the OBC

- 66 As well as including a statement of the support and commitment of the local authority (and other key stakeholders) for the project, the Executive Summary of the OBC should outline the key conclusions and recommendations arising from the development of the OBC, and give an analysis of the next steps required for taking forward the project.
- 67 If central government support is being sought for the project, it is vital that the necessary approvals from the relevant service Committee and/or Cabinet support the OBC, and that such approval is evidenced within the Executive Summary. This should not only include the date at which the conclusions of the OBC were approved, but also a recognition of the corporate commitment and resources required to deliver the project, and the contribution the project will make in delivering the local authority's corporate strategy, service strategy, CPA and Best Value Performance Plan.
- 68 Where the local authority has collected evidence of other stakeholder support for the project this should also be summarised within the Executive Summary.

Strategic Context and Business Need

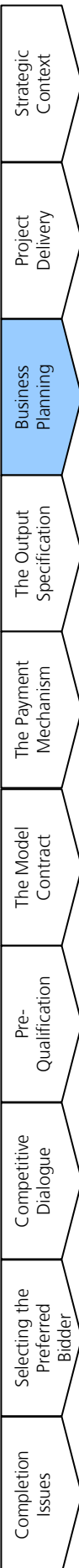
- 69 This section of the OBC should outline the key issues addressed as part of the initial strategic assessment for the project which are covered in Part One of this Procurement Pack. In particular, it should demonstrate that the project forms a logical and coherent part of the local authority's strategies and plans (this will minimise the risk of significant changes in direction at a later stage, will help attract bidders, and will provide a basis for evaluating any variant bids that may emerge later in the procurement process). It could also usefully summarise any evidence of public perceptions of the service noted during the initial strategic analysis for the project, and set out the impact or contribution of the project on existing partnership arrangements and other stakeholders of the service.
- 70 Where there is partnership working or forums for working with other organisations, these should be identified and the partners consulted as part of the preparation of the OBC.

Vires

- 71 As part of the process of developing the OBC, the local authority will need to identify the legal powers on which it intends to rely for entering into a contractual commitment for the service. The identification of these powers at an early stage in the development of the project is essential, and the Strategic Context section of the OBC should include a summary of the powers on which the local authority is relying.

Existing Services

- 72 An analysis of the existing arrangements for delivering the service is relevant when setting out the strategic context for the project in the OBC. This analysis should include current service costs and budgets, organisational and contractual arrangements, management responsibilities and standards of service being delivered. Commentary on the condition, age profile and risks associated with the current service assets or infrastructure should be included, as well as any asset condition surveys undertaken, with the dates of the survey and the extent and type of survey completed. The quality of the survey and asset condition data will be critical to an efficient bidding process.



73 There should also be a commentary on any local issues that require special attention or consideration. The OBC should demonstrate how the existing service contributes to the delivery of the local authority's objectives and whether the current level of resource and service delivery model supports the service and the local authority's objectives for the future. The OBC should highlight where the current service fails to maximise its contribution to the local authority's strategies.

Service or Project Objectives

74 To provide a clear focus for the appraisal of project and procurement options (and ultimately service delivery) it will be necessary to develop a range of aims and objectives that highlight the business need for the service, and the improvements required from the project. These strategic aims and project objectives must be developed in terms of the outputs that the project is required to deliver, and should flow from the underlying service strategy, CPA and/or Best Value Review.

75 It is important that objectives are clear and understood by all key stakeholders, and kept firmly in view as proposals are developed and taken forward. Wherever possible, the objectives specified should be SMART (specific, measurable, agreed, realistic and timely), capable of assessment against clear and measurable performance related criteria, and be defined in ways which allow their subsequent achievement to be evaluated.

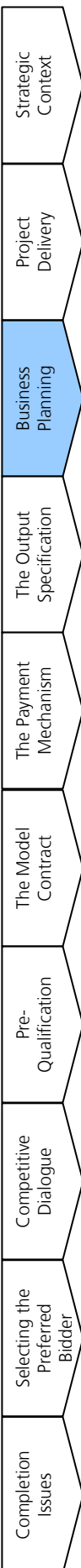
76 Describing objectives in terms of outcomes, outputs and required levels of performance, rather than in terms of inputs and resources that the project requires, tends to open up a wider range of solutions and promotes innovation in service delivery.

77 Having clear objectives at this stage will provide a focus for assessing the effectiveness, efficiency and potential of the project and procurement options available for delivery of the service. Without clear objectives, options will be ill defined or over-looked, incorrect weighting applied to costs and benefits, and risks and uncertainties not examined thoroughly.

78 Identification of key project outputs as part of the business planning process will assist the preparation of the Output Specification; the document that sets out what the local authority wants to achieve with the project in terms of outcomes and outputs. It will also assist in the development of a focused set of evaluation criteria for the evaluation of bids.

79 Costs and affordability of the various options can only be accurately assessed if the project is clearly defined. It is important therefore that the aims and objectives, and an Output Specification, are developed in sufficient detail at the OBC stage.

80 Where the local authority is considering seeking departmental financial support towards the costs of the project, it should take account of the criteria used by the department to assess and prioritise local authority business cases.

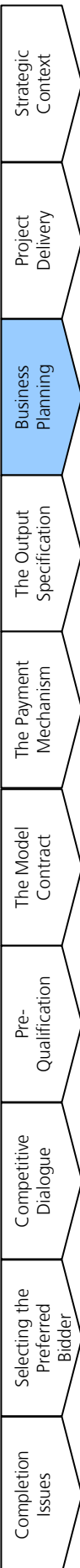


Options Appraisal

- 81 A critical stage in the OBC process is the identification and appraisal of a range of project options to identify the project that best meets the service delivery needs – the *Preferred Project Option* – and the appraisal of procurement or service delivery options (such as PFI) to identify the procurement or service delivery route that is likely to offer Best Value. The selected project and procurement/service delivery option will become the *Reference Project*, against which bids will subsequently be evaluated. If the evaluation of procurement options suggests that the most suitable route is procurement through a PPP or the PFI, the equivalent project option procured traditionally would form the *Public Sector Comparator* or *PSC*.

Project Options

- 82 In determining the project options available, the local authority might usefully undertake some soft market sounding, and/or consult local authorities that have previously developed and procured similar projects. Facilitated workshop with a range of stakeholders can be helpful to explore different approaches and options. An initial long-list of potential options which satisfy the service or project objectives will need to be refined to a short-list of typically between three and six project options that are likely to deliver an affordable and sustainable solution and are appropriate for detailed assessment and evaluation. The OBC should document the rationale for the de-selection of any option, and the basis upon which other options are being progressed for further analysis.
- 83 The short-listed options should each be examined according to non-financial and financial evaluation criteria, and a strategic commentary included in the OBC. It is important that each option is comprehensively appraised using a consistent and objective evaluation process. Further guidance on the financial evaluation process and developing the financial models for the options appraisal is included in Section 4 of this part of the Procurement Pack.
- 84 A key feature of any appraisal is that new investment and improvements in service delivery will change the status quo. Decision-making will therefore focus on whether or not to invest in change, and as a result the appraisal will normally include assessment against a base case, typically referred to as the *do nothing* option. This will allow the impact of change to be properly assessed.
- 85 Local authorities should always consider the implications of a do nothing option. If the case for change is sufficiently robust such an option will be unsustainable in the longer term because it will result in the local authority failing to meet its legal obligations at some point during the project life cycle, whether in terms of service provision or public safety. In the majority of cases it will be possible to discount such an option quickly, with the minimum of evaluation. A *do minimum* option is therefore a more likely real base case option. Typically this will involve minor changes to extend the life of the existing situation in the short-term.
- 86 In assessing the implications of the do nothing or do minimum option, all significant costs associated with the option should be estimated over the project life cycle. Such an option will have associated with it a number of risks, the more significant of which should be quantifiable. If the case for change is sufficiently robust it should not be surprising that such an option will have higher costs associated with it, and lower benefits than the preferred option. However, the do nothing or do minimum option should be maintained as a benchmark for comparison purposes, to highlight the implications of not proceeding with the project and provide a benchmark against which the costs and benefits of the other options can be compared.



- 87 In conducting the appraisal process, the local authority should balance the need to conduct a thorough analysis of the options with the need to develop the appraisal process, and not become too immersed in a detailed analysis of each of the options and potential variants at this stage in the appraisal process.
- 88 The OBC should set out the basis upon which each of the options identified has been appraised. A common set of evaluation criteria should be adopted to provide the basis of an objective appraisal process. For example, each option could be considered against the likelihood of the option achieving the defined project objectives. Each option must be evaluated in the context of service risks to ensure a like-for-like comparison. A risk register should be developed for the service or project to assist this process, with the risk quantification built into the evaluation process. Further guidance on risk identification, allocation and quantification in the context of a service project, and an example of a risk register, is provided in Section 6 of this Part of the Procurement Pack.
- 89 The appraisal of options should also take account of the Green Book requirements on optimism bias.
- 90 The most attractive option will be the option that represents the best 'trade off' between cost and benefits identified through the financial and non-financial appraisal. This will become the Preferred Project Option.
- 91 The OBC should include a summary of the results of the appraisal of project options, with the supporting information, such as the financial models, included as appendices to the OBC.

Procurement or Service Delivery Options

- 92 Once a Preferred Project Option has been identified, the next stage is to identify the potential procurement or service delivery options available to deliver it, and to establish which route is likely to be the most attractive to the local authority. The options or service delivery vehicles that have typically been assessed by local authorities in the appraisal of procurement options are illustrated in Figure 3.1.3.

Figure 3.1.3 – Procurement / Service Delivery Options



Strategic Context
Project Delivery
Business Planning
The Output Specification
The Payment Mechanism
The Model Contract
Pre-Qualification
Competitive Dialogue
Selecting the Preferred Bidder
Completion Issues

93 Even if the traditional procurement route is not deliverable because of constraints on the local authority's ability to raise capital within its prudential guidelines, this option must still be considered as it provides a benchmark against which to establish the value for money provided by the alternative procurement options. The costs of delivering the Preferred Project Option through traditional procurement will become the PSC. The PSC will need to be computed in accordance with the HM Treasury *Value for Money Assessment Guidance*. As set out in that guidance, once the choice of procurement route has been determined, the PSC is not required to be used again in the assessment of value for money, unless there is evidence of market failure or market abuse.

94 The OBC should outline each of the procurement options being considered and set out the process by which each will be appraised. Each option should be appraised against an agreed evaluation framework to establish which option offers the most viable and sustainable solution for the local authority. Possible criteria that could be used to evaluate different procurement options include:

- Ability to attract investment
- Affordability
- Timescale to delivery
- Practicality
- Legal issues associated with the option
- Anticipated procurement costs
- Bankability and deliverability issues, such as service provider interest in scheme
- Best Value.

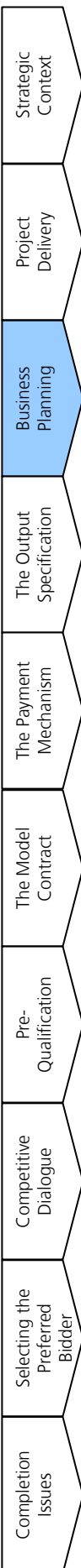
95 All procurement options should be evaluated in the context of anticipated service risks, as the different service delivery options will include different allocations of risk and responsibilities. The costs of each procurement option must therefore include the costs of the risks associated with the option to enable a like-for-like comparison. The appraisal of options should also take account of the Green Book requirements on optimism bias and taxation. Further guidance on these issues, in the context of developing the financial models and risk register, is included in Sections 4 and 6 respectively of this Part of the Procurement Pack. Local Authorities are also advised to refer to the HM Treasury *Value for Money Assessment Guidance* and the guidance produced by the 4ps *The Outline Business Case*.

96 The OBC should include a summary of the evaluation of procurement options, with supporting financial models included as appendices to the OBC.

97 The procurement option offering the best match with the selected evaluation criteria should be taken forward for further assessment. The rest of the guidance in this Section assumes that the PFI procurement option is shown to offer the most attractive solution and is the option to be taken forward.

Identifying the Costs for Options Appraisal

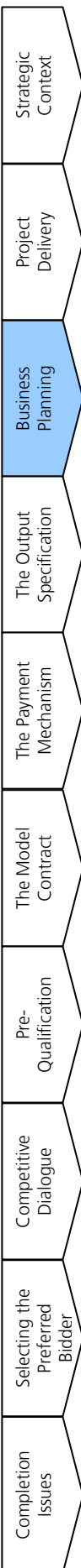
98 The costs of the various project options must be estimated on the basis of the assumptions set out in a draft Output Specification for the project or service, and not based on existing cost levels or service delivery arrangements. Guidance on the development of the Output Specification for a service project is included in Part Four of this Procurement Pack. If the local authority is hoping to deliver a step-change in the service, the new service levels must be reflected in the options appraisal exercises. It is important to bear in mind that the cost bases for a long-term performance-related Contract will be different to the costs of service delivery when the local authority retains key risks of service delivery.



- 99 Determining the cost base has often been a difficult area for local authorities developing an OBC, particularly given that in many instances the existing cost base bears limited resemblance to a specified level of service or performance-related Contract.
- 100 As part of the options appraisal work, local authorities are advised to test the resulting unitised cost assumptions for elements of the project or service with available 'norms'. These unitised costs might also be tested as part of the soft market testing exercise, through discussion with those local authorities already in the process of operating or procuring similar projects, through discussions with the local authority's financial and technical advisors and through discussions with the 4ps Transport Team.
- 101 In developing the costs of the various options it is also important that the local authority makes a realistic assessment of the assets and facilities that need to be replaced, in particular taking account of the whole-life/whole-service approach inherent in a PFI or PPP procurement, and the standards set out in the draft Output Specification. The quality of the asset condition information will be important to this assessment, and it is suggested that the assumptions made by the in-house team be tested with technical/financial advisors involved in other similar projects and, perhaps, as part of the soft market testing exercise.

Market Sounding or Deal Testing

- 102 In undertaking the appraisal of both project and procurement options, it is recommended that the local authority undertakes a soft market testing or deal testing exercise with potential service providers to test the assumptions being used in the appraisal exercises. This can also be a useful way for the local authority to gain insight into the likely level of interest in the project and how a service provider might approach the delivery of the service and address local circumstances.
- 103 In carrying out a soft market testing exercise, one option may be for the local authority to approach those service providers with whom it is used to doing business to discuss its ideas about the scheme, and to invite suggestions as to how it might be taken forward. Other companies and consortia active in the service market may also be approached. The local authority's advisors may also be able to facilitate informal approaches to the market.
- 104 It is important that any one potential bidder is not given a head start in the procurement process. The local authority must take legal advice before approaching the market to ensure that its actions do not distort competition or prejudice the future procurement process. The local authority should ensure that the principles of equality, transparency and competition are observed. Such an exercise may best be undertaken with the issue of a Prior Information Notice (PIN), and a selection process used to select, say, three potential service providers with whom to discuss the proposed project.
- 105 Preliminary information about the project and the local authority's aspirations for the service may usefully be provided prior to the market sounding interviews. In accordance with the equality principle, local authorities should ensure that other interested parties are provided with the same information as those participating in the discussions to ensure that the latter are not given a competitive advantage.
- 106 If responses from the market sounding exercise indicate that the proposed scheme is unfeasible, or that there is not likely to be much competition during the bidding process, local authorities will need to consider carefully how to proceed further.



The Preferred Option (Reference Project)

- 107 The preferred project and procurement option identified from the options appraisal exercises will become the Reference Project against which bids will subsequently be evaluated. Although a Reference Project, it should be remembered that it only represents one way of delivering the project and the local authority should encourage innovative solutions and other approaches as part of the subsequent procurement process. For the OBC, the following information is also required in respect of the Reference Project:

Statement of Benefits

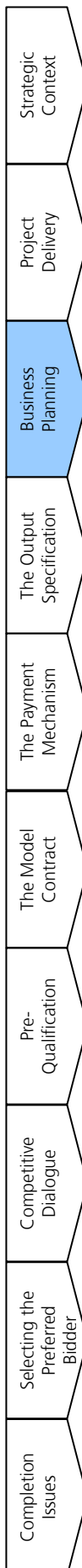
- 108 An indication of the benefits that are expected to be realised by taking forward the selected Reference Project should be set out in the OBC. Some sponsoring departments require the benefits to be quantified, and have developed specific approaches that need to be followed to quantify the cost-benefit-ratio. Further details on assessing the benefits in the service area are set out in Section 2 of this Part of the Procurement Pack.

Best Value

- 109 A key aspect of the evaluation of procurement options should be to demonstrate that the chosen procurement route is able to offer Best Value. A Best Value comparison at an early stage represents good practice, and should be prepared in all instances where a local authority is considering procurement of the project through a PPP or PFI, even though traditional funding sources may not be available. As noted in HM Treasury *Value for Money Assessment Guidance*, once the choice of procurement route has been determined, the PSC is not required to be used again in the assessment of value for money, unless there is evidence of market failure or market abuse.

Affordability

- 110 It is essential that the Reference Project is affordable to the local authority, and the assessment of the affordability over the whole life of the project is an essential element of the OBC. This assessment should be made early in the process and should be a core aspect in the approval of the project by members and other stakeholders. No procurement should proceed without a vigorous analysis of affordability, and the OBC should include an explicit statement of commitment from members to the costs of the project.
- 111 A thorough analysis of the affordability of the Reference Project should be completed and shown in summary form within the OBC, with supporting financial models contained within the Appendices. Further guidance on the assessment of the affordability of the project is contained in Section 4 of this Part of the Procurement Pack.
- 112 If the local authority is seeking central government financial support towards the costs of the project, the sponsoring department and the PRG will be concerned to ensure that the local authority has completed a thorough analysis of the anticipated costs of the project, and can afford the selected option. This analysis will require the local authority to calculate a PFI credit allocation to support the project. Section 5 of this Part of the Procurement Pack outlines the departmental method of calculating PFI credits for projects in the service area, and the guidance on developing the financial models in Section 4 indicates how the revenue support should be reflected in the financial models.



- 113 The assessment of affordability should be subject to sensitivity tests (such as changes in interest rates and discount rates) so that the local authority can give the necessary approvals for the project in full awareness of the future funding commitments associated with the chosen project and procurement route, and the level at which it can afford to fund the selected project.

Bankability

- 114 The financial analysis should ensure that the Reference Project provides a potential service provider with a bankable solution, demonstrating that a service provider can make a competitive return on the project whilst meeting its debt service obligations. A thorough analysis of the bankability of the Reference Project should be completed and shown in summary form within the OBC, with the financial models supporting the assessment. Guidance on the assessment of the bankability of the project is contained in Section 4 of this Part of the Procurement Pack.

Output Specification

- 115 The OBC should outline the local authority’s proposed service requirements, summarised from the Output Specification developed as part of the business planning process. Part 4 of this Procurement Pack includes guidance on developing the Output Specification. At the OBC stage the local authority should have a well-developed draft of the Output Specification in place, with the draft used as part of the options appraisal exercises. The OBC should include a summary of the key elements of the draft Output Specification and commentary on how the Output Specification will be developed further.

Payment Mechanism

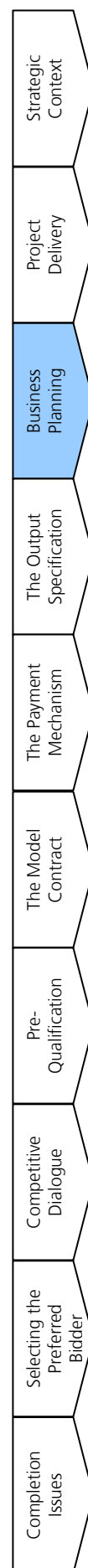
- 116 The local authority will expect to pay the service provider for the delivery of the services identified within the Output Specification and a Payment Mechanism is required for this purpose. For a PFI scheme the Payment Mechanism should be based on a unitary charge for the satisfactory delivery of the service, with payments to the Service Provider varying if the service is not delivered to the agreed performance standards. Part Five of this Procurement Pack includes guidance on developing the Payment Mechanism. At the OBC stage, the local authority will need to have given thought to the components of the Payment Mechanism, and how the Payment Mechanism will interact with the requirements of the Output Specification. The OBC should include a summary of the key components of the Payment Mechanism and commentary on how the Payment Mechanism will be developed further.

Indexation, Benchmarking and Market Testing

- 117 The OBC should set out the local authority’s initial views on indexation, benchmarking and market testing, which will be included as part of the Payment Mechanism and Contract for the services. It is likely that part of the unitary charge will be subject to an indexation arrangement based on the Retail Prices Index (RPI).

Contract Monitoring

- 118 The OBC should include the local authority’s preliminary proposals for monitoring the service provider’s performance in the delivery of the service. Local authorities should aim to incorporate self-monitoring by the service provider, with the local authority having the right to audit the service provider’s procedures and records. The OBC should set out how the local authority proposes to develop its approach to contract monitoring and the expected level of client-side involvement.



Contractual Terms

- 119 The OBC should set out how the local authority will develop the Model Contract for the project. It is recommended that Local Authorities use the Sector Specific Contract included in this Procurement Pack as a basis for the project (which is based on the HM Treasury *Standardisation of PFI Contracts*, and reflects the derogations agreed with the relevant department and HM Treasury). For local authority projects awarded a PFI credit, the sponsoring department will require an explicit agreement from the local authority, as part of the OBC, to use the Sector Specific Contract as approved by department and HM Treasury, and the local authority will subsequently be required to submit a statement of any derogations from the Sector Specific Contract as part of the Final Business Case.

Employee Issues

- 120 The OBC should provide a commentary on the local authority's intended approach to the staffing implications of the project, and the extent to which the TUPE regulations may apply. In particular the OBC should consider:

- The principles by which the process of any staff transfers would be conducted, including those from the existing service providers
- The arrangements that are to be put in place for consulting with staff and the staff representatives during the procurement process and following financial close
- How the good practice guidance on employee consultation matters, from the Cabinet Office, DCLG and the 4ps, will be applied
- How the *Code of Practice on Workforce Matters in local authority Service Contracts* and model Contract clauses published by the 4ps, IDeA and Employers Organisation will be applied
- The proposed arrangements for involving staff and staff representatives in the process for selecting a service provider, and appraisal of employment policies, industrial relations track record, training and development policies
- Arrangements for dealing with pension issues.

Risk Register

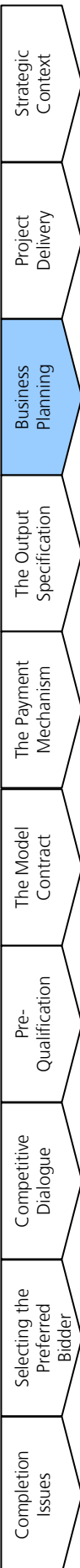
- 121 The OBC should include a copy of the risk register for the Reference Project and details of the risk quantification used in the options appraisal exercises. The identification, allocation and quantification of the risks associated with a service project are discussed further in Section 6 of this Part of the Procurement Pack.

Accounting treatment

- 122 Please see Part Ten of this Procurement Pack.

Financial Assumptions

- 123 The OBC should include, as an appendix, a summary of the financial assumptions used in developing the Reference Project. This table should include as a minimum the following:
- Details of data sources and assumptions used in determining the cost bases for the project



- Details of the value engineering and efficiencies assumed in the PFI or PPP procurement option
- A summary of the risk quantification used for capital costs, operating costs, revenues, and other income
- An outline of the optimism bias adjustment used in the development of project costs
- Financing rates for debt and equity
- Key financing ratios
- Inflation, indexation and interest rate assumptions
- Where a PFI credit is being sought, the assumptions used in the computation of the PFI credit and revenue support, and a table setting out and cross referencing to where the OBC meets the criteria set by the sponsoring department, and the deliverability criteria used by the PRG.

Project Delivery Arrangements

- 124 This section of the OBC should document the local authority's intended approach to the procurement of the project and set out the key issues that are to be addressed in the subsequent development, procurement and delivery of the project. The key elements, on which commentary should be included in the OBC, are:

Implementation and Project Management Plan

- 125 This section of the OBC should describe the project management and governance arrangements that are in place, or are to be put in place, to ensure an efficient procurement. As a minimum, it should identify the project director, the project owner, the project team, the strategic project board, and the approval, delegation, reporting and governance arrangements that have been agreed for the procurement stage. Where external advisors are required to support the in-house team, the OBC must include details of the budget that has been made available for this, details of the advisors appointed, or an outline of the proposed arrangements for the appointment of external advisors (technical, financial and legal).
- 126 Further guidance on developing the project management arrangements for a PFI/PPP project is included in Part Two of this Procurement Pack.

Procurement Timetable

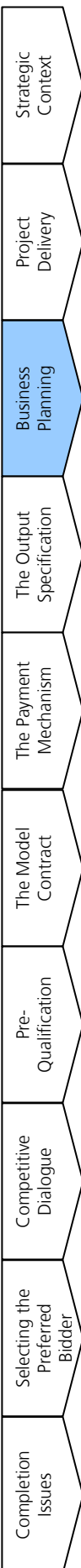
- 127 The OBC should include a copy of the intended procurement timetable. An example of a procurement timetable, with indicative periods for each stage in the procurement process, is included in Part Two of this Procurement Pack.

Consultation Arrangements

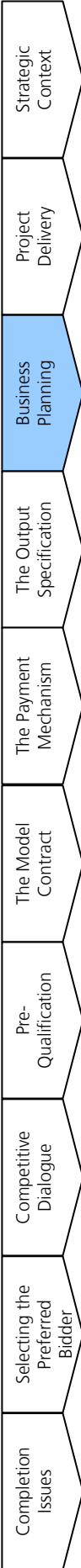
- 128 The OBC should set out the arrangements to be followed for consulting with relevant stakeholders during the procurement process.

Additional OBC Guidance

- 129 4ps Transport Team has produced general guidance on business planning *The Outline Business Case*.
- 130 Local authorities considering the PFI or PPP route are also advised to contact local authorities that have had a scheme approved, and to look at their OBC. A list of approved schemes is available from the DCLG website (www.communities.gov.uk). Local authorities are advised to



Speak to 4ps Transport Team before making contact in order to get the most up-to-date position on individual projects.



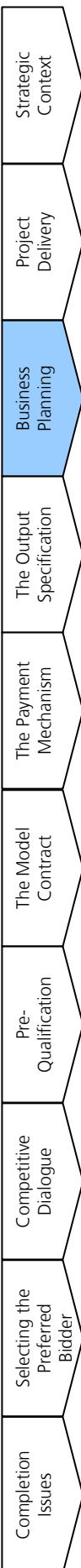
Section 2 Key Issues for a Street Lighting Scheme

Bidding Rounds

- 131 The DfT have introduced a bidding process for local authority street lighting PFI Credits based on expressions of interest. Such a process enables local authorities to obtain an early indication from the DfT as to whether the street lighting project will be supported financially before the local authority is required to undertake the more detailed work on the OBC. Information on the latest bidding rounds can be obtained from the 4ps or DfT.
- 132 The DfT have specific criteria in relation to street lighting Business Cases and these criteria are reproduced in Sections 2 and 4 of this Part of this Street Lighting Procurement Pack. The guidance explains how the DfT will review and assess the proposed project against departmental policies and priorities, and how it will assess the extent of central government support for the project.
- 133 The DfT will forward the street lighting OBCs they wish to support to the Project Review Group (PRG) for the review of project 'deliverability'. Projects satisfying both the DfT and PRG criteria will be awarded a PFI credit and the approval of the project will be published. This process gives explicit indication to potential bidders that the project meets the departmental and PRG criteria, including importantly that the PFI Reference Project set out in the OBC has been independently assessed as being affordable.
- 134 Local authorities should be aware that an initial allocation of PFI funding will be made on the basis of the outline proposal or expression of interest submitted by the local authority as part of the bidding round. It is important that local authorities undertake sufficient work at the initial stage on the assessment of project and procurement options to ensure that costs and affordability are fully assessed and robust. The 4ps Transport Team suggest that local authorities follow the principles set out in this guidance on the OBC in developing such outline proposals. The expression of interest is effectively a mini-OBC.

Project Scope

- 135 The scope of the project is an issue for each local authority and will depend upon local organisational and service delivery issues, and the results of the strategic service review, CPA or Best Value review. This Street Lighting Procurement Pack is written on the assumption that the project will cover street lighting, illuminated traffic signs and other forms of public lighting provided in car parks, parks, subways, and for the purpose of floodlighting public buildings.
- 136 Other options for local authorities might include considering the benefits of developing and procuring a street lighting project jointly or in collaboration with a neighbouring local authority, or procuring the street lighting service as part of a wider highways management PFI scheme. Local authorities will need to assess the options available locally, and determine the most appropriate scope of a project given the local circumstances.



137 If a local authority has previously been given provisional approval to a project though the DfT bidding round, the OBC might also highlight any departures from the scheme provisionally approved.

Strategic Context and Business Need

138 The analysis in the OBC might usefully focus on the key service benefits, in particular:

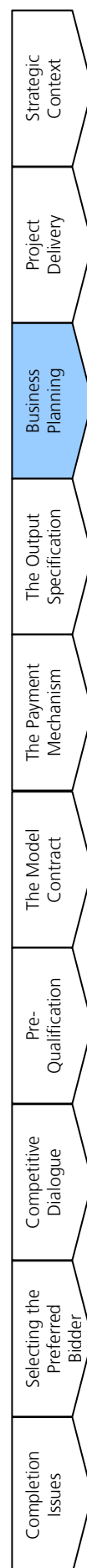
- Road safety (especially the severity and frequency of night-time accidents)
- The incidence of night-time crime
- The perception of safety and security in the streets and back lanes at night and how improved lighting could reduce the fear of crime
- Leisure and commercial activity after dark, which can improve the vitality of town and city centres
- Walking, cycling, and the use of public transport as alternatives to the private car
- Safer routes to school
- Improved street scene for local people, business and tourism
- Reduction in light pollution and spill lighting
- Potential reductions in energy consumption and carbon emissions from better management, control gear and technological innovations (such as white light, LEDs, remote monitoring and reflective signs and bollards)
- Improved sustainability
- Increased economic activity and employment opportunities particularly during the Core Investment Period.

139 The strategic context section of the OBC could also usefully summarise any evidence of public perceptions of the street lighting service, how these perceptions have developed over time, and how they reflect demand for better quality or more efficient services. Where there is recent, available analysis of public and community opinion surveys on trends in relation to the performance of the street lighting service, this should be included in support of the need for development or improvement of the service.

140 It may also be useful to include a summary of the analysis of the public's interaction with the service through:

- The results of the LTP or Best Value consultation processes in relation to the street lighting service
- Analysis of the numbers and frequency of requests for service and/or complaints
- Analysis of the requests for improved street lighting
- The results of other surveys/initiatives where improvements to the lighting service have been cited as a means of improving the effectiveness of other local authority activities (for example safer routes to schools, area community safety/regeneration initiatives and redevelopment proposals).

141 The OBC should also set out the impact or contribution of the project on existing partnership arrangements and other stakeholders of the service. Where there is partnership working or forums for working with the emergency services, development agencies or other relevant organisations, these should be identified and the partners consulted as part of the preparation of the OBC.

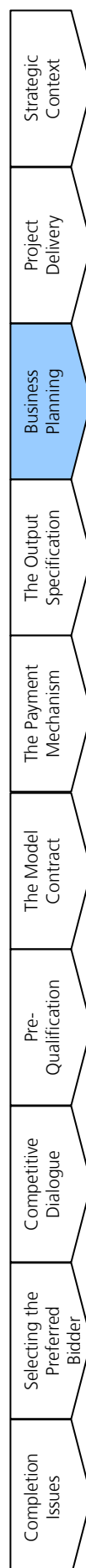


Vires

- 142 As part of the process of developing the OBC, local authorities will need to identify the legal powers on which it intends to rely for entering into a contractual commitment for the street lighting service. The identification of these powers at an early stage in the development of the project is essential, and the Strategic Context section of the OBC should include a summary of the powers on which the local authority is relying.
- 143 Although local authorities will need to take their own legal advice on this issue, the key powers for the project are likely to be included within the following:
- Highways Act 1980
 - Local Authorities (Deregulation and Contracting Out) Orders
 - Local Government Acts 1999 and 2000 (Best Value and Well-Being Powers)
 - Local Government (Contracts) Act 1997.
- 144 Whilst the appropriate powers will need to be identified in the OBC, this is not considered to be a troublesome issue in relation to street lighting projects.

Existing Services

- 145 Analysis of current service standards/arrangements might include:
- Key policies and strategies in place
 - Inventory profile (including lighting point numbers, age, type of column, lighting design levels/standards provided, light sources and electrical profile/loading), ideally analysed in accordance with the DfT guidance on street lighting inventories issued in January 2002
 - Trends in the recent service costs and budgets
 - Performance against Best Value Performance Indicators and any local Performance Indicators
 - Arrangements in place for the discharge of design, maintenance and energy procurement functions
 - Key features of the cyclical maintenance regime in place
 - Fault response targets
 - Trends in equipment replacement/repair activity.
- 146 In addition, this section of the OBC should include commentary on the condition, age profile and risks associated with the current lighting infrastructure. This should include a commentary on any stock condition surveys undertaken, including the dates of the survey and the extent and type of survey completed (such as visual and destructive/non-destructive testing). The quality of the survey and stock condition data will be critical to an efficient bidding process.
- 147 There should also be a commentary on any local issues that require special attention or consideration, for example accelerated deterioration that may be caused by proximity to a coast, vibration from main thoroughfares, and local remedial actions previously taken (for example, improvement and replacement programmes and column 'sleeving').
- 148 In particular, the OBC should focus on the extent to which the lighting service meets the local authority's aspirations with respect to lighting design standards (EN 13201), the effectiveness of the light sources provided, the risks associated with the operation of the current lighting infrastructure, and the sustainability of the current resource and delivery model.



Service or Project Objectives

- 149 Where the local authority is considering seeking DfT financial support towards the costs of the project, in determining the service or project objectives the local authority may also need to give thought to the criteria used by the DfT to assess and prioritise local authority business cases.

Project Options

- 150 For street lighting schemes the project options carried forward for more detailed assessment has typically included:

- Do nothing – maintain the status quo regarding the existing budgetary provision and operational offerings (sometimes referred to as the Continue Existing option)
- Do the minimum – assess the project against the delivery of the minimum service to maintain the existing service in the medium term, including the additional investment required
- Accelerated replacement – fast-track investment to modernise the lighting infrastructure
- Life expiry replacement – an investment approach informed by the risk analysis of the life expectancy to modernise the lighting infrastructure
- Replacement of the entire lighting stock.

- 151 As set out in the DfT guidance (see sections 2 and 4) the do minimum option should reflect the application of the estimated Relative Needs Formulae (RNF) funding to the service. Since there is no specific street lighting RNF, local authorities will need to make a reasoned estimate of this, such as by reference to the expenditure position on highways maintenance RNF.

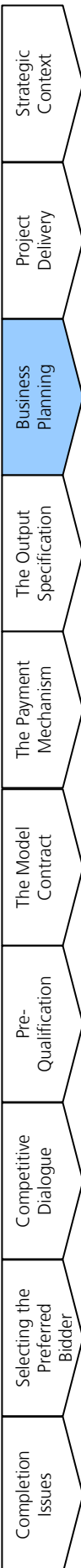
- 152 The OBC should set out the basis upon which each of the options identified has been appraised. It is important to adopt a common set of evaluation criteria that should provide the basis of an objective appraisal process. For example, each option could be considered against the likelihood of the option achieving the defined project objectives, which could include some or all of these criteria:

- The provision of lighting and traffic signs to the appropriate design standard throughout the area
- The provision of a safe, sustainable and high-quality street lighting infrastructure
- The achievement of Best Value
- Improving the contribution the service makes to a local authority's corporate aims, strategic and operational service objectives
- The achievement of these objectives in short time-scales.

- 153 The DfT require an Assessment Summary Table (AST) to be completed for the Reference Project and the do minimum option. It is therefore considered good practice to evaluate the project options against the five key AST criteria (accessibility, economy, environmental impact, integration and safety) to provide a consistent basis for the consideration of the project options. Preparation of the AST is covered in section 2 of this part of the Procurement Pack.

Procurement Options

- 154 The options or service delivery vehicles that have typically been assessed by local authorities in the appraisal of procurement options for a street lighting scheme have included:



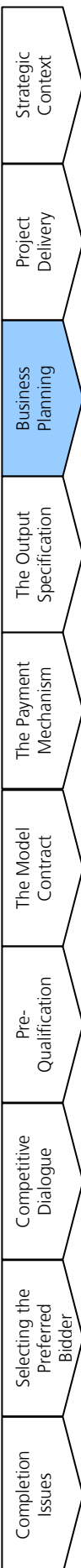
- Working jointly or in collaboration with other local authorities
- The use of a public interest company, trust or other non-profit making vehicle
- Leasing
- Other PPP options, such as a strategic service partnership or joint venture with the private sector.

Statement of Benefits and Appraisal Summary Table (AST)

- 155 If the local authority is seeking central government financial support towards the costs of the project, the DfT will require the OBC to include an assessment of the economic and transport benefits associated with the preferred project and procurement option. This needs to be completed in accordance with DfT guidance and, in order for the OBC to be viable, should demonstrate that the economic and transport benefits associated with the project outweigh the costs of investment (i.e. the AST analysis should show that there is a positive Benefit-Cost Ratio associated with the project).
- 156 In undertaking this exercise, it is suggested that a sensitivity analysis is included to demonstrate the effect of different benefit assumptions on the Benefit-Cost ratio.
- 157 To provide a benchmark for comparison purposes, the DfT also requires an AST to be completed for the Do Minimum option (the Do Minimum in this regard is defined in the DfT guidance).
- 158 Guidance on the completion of the AST for the Reference Project and Do Minimum option is included in Section 2 of this Part of the Procurement Pack.

Payment Mechanism

- 159 Assuming that the local authority will follow the structure used in this Procurement Pack, the performance standards used in the Output Specification are also used to determine the amount of unitary charge payable to the service provider. These cover the following aspects:
- The lighting installation should be designed to the relevant British or European lighting standards and equipment specifications (or successor standards). The unitary charge is reduced where the lighting installation does not meet such standards
 - Ensuring that the lighting Apparatus is in light and provides lighting in accordance with its design and that each type of Apparatus is maintained effectively to ensure its structural, mechanical and electrical safety. The unitary charge is reduced where Apparatus is not in light (below a threshold) or does not meet expected lighting outputs or where the equipment is not inspected and maintained in accordance with the agreed frequencies
 - Ensuring emergency and non-emergency faults are responded to and rectified in accordance with the agreed performance targets. The unitary charge is reduced where the target times are not met
 - The service provider's performance in responding to and dealing with requests for service, complaints from customers, and maintaining the management information database
 - The service provider's performance on strategic assistance and reporting (to ensure that the local authority is able to meet its statutory obligations in relation to the LTP, CPA and Best Value)

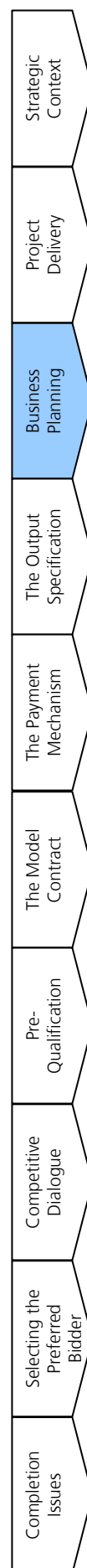


- The service provider’s compliance with statutory and legislative requirements, relevant regulations, codes of practice and good working practices
- The service provider’s performance in reporting to the local authority
- The service provider’s performance in completing any proposed lifecycle replacement of the deemed to comply columns planned after the Core Investment Programme.

Contractual Terms

160 The OBC might usefully include an indication as to how the local authority expects to deal with the key contractual issues. This might include commentary on the following:

- The term or length of the proposed Contract (this is typically 25 years)
- The treatment of the initial stock condition survey and the risks associated with the accuracy and completeness of this information
- How licences and titles will be dealt with
- The proposals for any depots
- Revenue sharing arrangements (including arrangements in relation to service connections and energy savings)
- Arrangements for the hand-back of assets at the end of the Contract and the associated residual value issues
- How the change mechanism and payment mechanism will deal with variations to the level of lighting stock, such as column additions through road de-trunking, adoptions, housing transfers and boundary changes.



Section 3 Benefits Appraisal

Introduction

- 161 Local authorities are required to include in the OBC an Appraisal Summary Table (AST) for both the preferred project and procurement option (assumed to be the PFI Reference Project) and the Do Minimum option. The DfT guidance on the appraisal framework for street lighting projects is reproduced in figure 2.2.1 (with the terminology and cross-referencing changed where appropriate).

Figure 3.3.1 – DfT Guidance on the Appraisal Framework for Street Lighting Projects

<p>In preparing proposals for street lighting PFI schemes, local authorities will be required to provide information on the various aspects set out below. These will give a consistent method of comparing schemes and deciding on whether they should be supported, along with the more general criteria for PFI schemes.</p> <p>Appraisal Summary Tables (AST)</p> <p>Each scheme will have economic analyses carried out under the Guidance on Multi-Modal Studies (GOMMS). An AST will be produced for the options set out below.</p> <p>Options</p> <p>As a minimum, an AST will be produced for the preferred project and procurement option and the Do Minimum situations. For a definition of Do-Minimum see Section 4 of this Part of the Procurement Pack.</p> <p>Quantification of Benefits</p> <p>An AST presents benefits and costs (whether monetised, quantified, or expressed in qualitative terms) in a balanced way. Where possible, benefits should be expressed in quantitative terms. However, the GOMMS provides ways of presenting information for all impacts.</p> <p>Financial Analysis</p> <p>A financial analysis will be carried out for public sector procurement of the Do Minimum situation. For the preferred option, financial analyses will be carried out for both private and public sector procurement.</p> <p>Period of Appraisal</p> <p>The period of appraisal will be 25 years for all schemes. Most projects are between 20 and 25 years in length. (The life of a lighting column is about 25 years.)</p> <p>Cost</p> <p>The total cost, revenue and capital, of schemes will be shown. This will give an indication of affordability. The unit cost per lighting unit over the life of the scheme will also be shown as a rough indication of comparative efficiency between schemes.</p>	
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- 162 The objective of the AST is to provide a consistent basis for the evaluation of the economic and transport benefits associated with different service delivery options, and to demonstrate which option offers Best Value through the comparison of Benefit-Cost Ratios (BCR). The BCR is calculated through the quantification of the anticipated economic and transport benefits arising from particular options in comparison with investment costs.

The Appraisal Summary Table

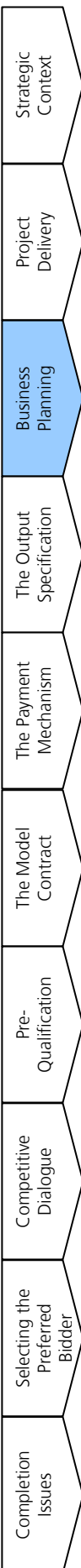
- 163 Guidance on completing the AST can be found in the DfT *Guidance on Multi-Modal Studies (GOMMS)* available from the DfT website (www.dft.gov.uk). A pro-forma AST is also available from the DfT website.
- 164 The GOMMS requires that analysis be completed in relation to the impact of each option in relation to:
- Environment
 - Safety
 - Economy
 - Accessibility
 - Integration
- 165 The AST document is applicable to all types of transportation project and therefore some of the evaluation criteria will not be relevant to a street lighting project. However, the AST will need to highlight the impact of implementing the option over each of these criteria and a commentary (with potential data sources) for each of the evaluation criteria is provided here:

Environment

- 166 Street lighting projects do not in themselves address the subsidiary objectives stated in the GOMMS. However, the modernisation of street lighting will have a quantifiable environmental impact. The AST analysis should highlight the assessed environmental impact of each option. This analysis should take into account, and where possible quantify, the impact of each option in relation to:
- CO2 emissions
 - Waste management implications
 - Energy efficiency/management
 - Visual obtrusiveness
 - Light pollution.

Safety

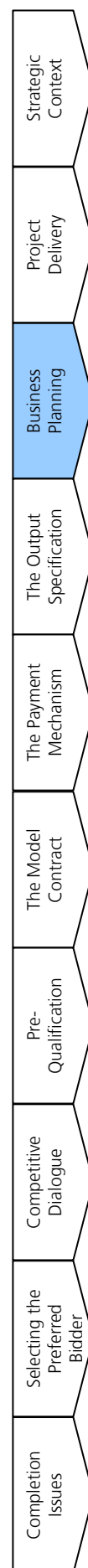
- 167 The AST analysis should highlight the assessed impact of each option in relation to road traffic accidents and crime.
- 168 There is a body of research evidence that suggests improved street lighting can substantively reduce the occurrence of night-time road traffic accidents (for example, the Institution of Lighting Engineers and Transport Research Laboratory reports). This evidence suggests that the percentage reduction in night-time accidents following new investment in street lighting can vary from 15% to 35% depending on local circumstances. The DfT Highways Economic notes provide details of the valuation to be used in quantifying the benefits through the reduction/prevention of road traffic accidents and casualties.
- 169 Using these data sources it is possible to quantify the potential impact of reducing the number of night-time road traffic accidents for each option during the assessment period, taking account of the different investment profiles associated with the different options. The evaluation should be completed over 25 years and a discount factor (currently 3.5% real) should be used to arrive at an NPV of the expected benefits.



- 170 The Institute of Criminology, University of Cambridge, has conducted the most extensive research on the link between lighting levels and crime. This work included two rigorous studies to compare the changes in crime, disorder, fear, quality of life and night-time street use over a 12-month period following the upgrading of lighting to high pressure sodium (SON) BS 5489. The same comparisons were made in adjacent and control areas where lighting remained unchanged.
- 171 The studies suggested that the incidence of crime in re-lit areas fell substantially and that there were also a number of wider economic and social benefits (for example, reduced fear of crime and increased night-time street use). However, the nature of the link between the incidence of crime and the level and type of light required remains uncertain. It is not clear how the incidence of crime changes with the attainment of different standards and whether similar benefits are attainable with different lighting sources.
- 172 The Institute of Criminology's work concentrated on residential areas where there is an increase in lighting levels from below BS 3/3 to BS 3/2 and BS 3/1. It is difficult to judge the additional impact of raising lighting levels to BS 3/1, or the benefits of changing lighting sources (for example from SOX or MBF to SON or white light) as no substantive research exists in this area. The Institute's research suggested a reduction in crime rates attributable to improved lighting of over 25%. Other appraisals of street lighting improvements have suggested more modest reductions in night-time crime of between 15% and 25%.
- 173 Using these data sources it is possible to quantify the potential impact of reducing the number of night-time crimes for each option during the assessment period, taking account of the different investment profiles associated with the different options.
- 174 The analysis of the benefits arising from the potential reduction in night-time road traffic accidents and crime should be subject to a sensitivity analysis and the results of this should be presented in summary form within the OBC.

Economy

- 175 Journey times and vehicle operating costs will not be directly affected by lighting improvements. However, improved signage should have a positive effect upon both of these areas.
- 176 Journey time reliability is not an expected outcome of improved street lighting but wider regeneration may follow from additional investment in street lighting. Investment in street lighting is often beneficial in terms of the stimulation it brings to the night-time economy and promoting safety in the community. The Institute of Criminology's research concluded that better lighting produces a profound effect in the community in the following ways:
- Reductions in crime and the fear of crime
 - Job creation
 - Improvements in visibility and encouragement of more street use by residents
 - Improvement in community confidence and civic pride.
- 177 The Institute of Criminology's research suggested that re-lighting areas had a marked effect on change in street use after dark. In one study the numbers of people using the street after dark (based on pedestrian head counts) increased dramatically. The research demonstrated that better lighting had positive effects on a number of groups. In the two study areas, night-time use of streets by women increased by 28% and 70% respectively. In addition, elderly people benefited significantly through reduced vandalism and disorderly behaviour and following a survey amongst young people, results showed that there was a significant decrease in victimisation amongst 11 to 17 year-olds.



178 It is likely that the increase in night-time street use will also have a positive impact on the local retail and entertainment economy. The cultural and quality of life impact associated with lighting improvements is also an important area for assessment. One of the main objectives in providing street lighting services is to support the social and cultural needs of the community, thereby promoting a feeling of well being and civic pride within the community. Data collected during the Institute of Criminology’s research project analysing the relationship between improved lighting and culture and quality of life suggested that there could be a positive effect. Analysis from the research project highlighted a number of benefits including:

- 19% increase in those feeling very/fairly safe while walking alone after dark
- 40% increase in perceptions that quality of life had improved in re-lit areas
- 63% increase in perceptions that the area was well lit
- 16% increase in those believing local members understood problem areas.

Accessibility

179 Good quality lighting has particular benefit to pedestrians, cyclists and equestrians by improving night-time visibility. The changes in amenity and the numbers affected are rated as high and, although no new transport routes are likely to be included as part of a street lighting project, there may be a very significant increase in the use of existing ones.

180 Good lighting can also improve access to public transport. Whereas the AST guidance is written on the assumption that new transport routes are being appraised, improved lighting should have a positive effect on public transport usage in the hours of darkness, particularly for those with any form of vision impairment.

Integration

181 Improved street lighting will bring benefits in terms of encouraging more use of public transport, walking and cycling during the hours of darkness being beneficial in encouraging these modes as part of an integrated transport strategy.

Calculating the Benefit-Cost Ratio

182 A key element of the AST is the quantification of the benefits resulting from the investment in the street lighting service. In order to be able to calculate these benefits, local authorities will need to determine the likely levels of reduction in road traffic accidents and reductions in various types of crime resulting from the new investment and incorporate these into a model in order to compute a BCR.

183 To assist local authorities with this process, a Worksheet has been developed for this Procurement Pack (Worksheet 2 – AST Benefit-Cost Calculations).

184 Local authorities intending to use Worksheet 2 to compute the BCR for a street lighting scheme must ensure that the multipliers (such as the assumed loss figures and average cost of an accident) are based on the most up-to-date information available, and that the reduction levels can be justified by local circumstances.

185 Whilst it will be up to each local authority to determine the relevant benefits of new investment in street lighting, an AST for one of the approved schemes (appropriately de-sensitised) is shown in figure 3.3.2 for general reference.

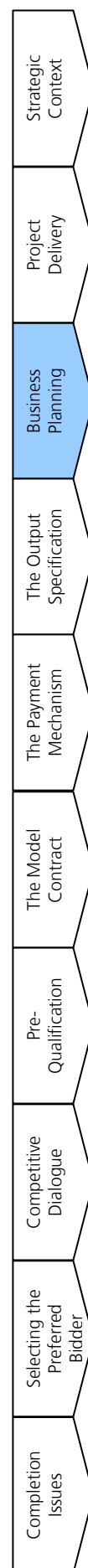
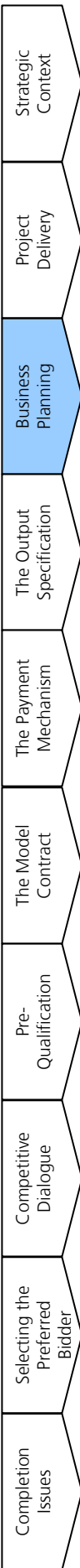


Figure 3.3.2 – Example of the AST for a Street Lighting Scheme

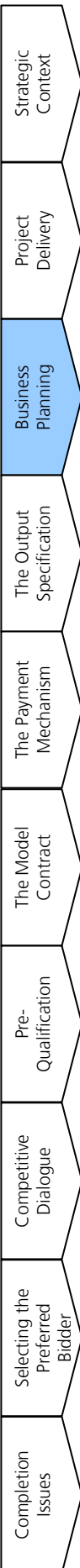
Local Authority - Street Lighting Services	Street Lighting Replacement and Improvement Project	£m (PV Capital Costs)		
Problems	<ul style="list-style-type: none"> Outdated, dilapidated, life expired, under-performing and failing street lighting infrastructure which generates high operating costs, delivers poor quality services and does not meet the needs of a modern City. Significant investment needed throughout the City to replace life-expired columns, to prevent major system failures, to improve performance and costs and to deliver wider community and social benefits. 			
Other options	<ul style="list-style-type: none"> Do Minimum – basic capital programme to replace, sleeve and repair life-expired columns to meet basic safety and operating requirements – offers no significant improvements in costs or performance, delivers no wider community and social benefits and presents increasing risk of significant system failures. Continue Existing – broadly maintains existing level of capital investment - does not address backlog of replacements – rate of failures would quickly outstrip capacity of 'fire fighting' maintenance – safety problems and major system failures likely. Full infrastructure replacement – substantial, ongoing programme of column replacements to bring whole system quickly to BS 5489 standards – includes provision for some premature replacements and hence does not represent best value. 			
Preferred Option: Fast Track Infrastructure Renewal procured through the PFI		<ul style="list-style-type: none"> Fast-track infrastructure renewal – initial fast-track capital investment programme of targeted improvements to address urgent backlog of column replacements and to improve lighting levels, efficiency and costs. 		
Criteria	Sub Criteria	Qualitative impacts	Quantitative measures	Assessment
Environmental impact	Lighting levels	Improved lighting levels, generally to BS5489	Measured service delivery to BS5489	Large positive
	Streetscape	Better illumination and more congenial, safer night-time environment	x% of failing and outdated columns replaced over first 5 years	Large positive
Heritage		Sympathetic column replacement and lighting improvements in conservation and heritage areas	Provision for installation of "heritage" columns	Positive
	Safety and security	Road Accident Reductions	Targeted reductions in current above average rate of injury to pedestrians and car occupants	Estimated 15% reduction in night-time injury accidents
Crime Reductions		Reduces fear of crime, reductions targeted on street crime and hotspots	Estimated 15% reduction in street crime	£m (PV Benefits)
	Economy	Journey times and VOCs	Improved night-time visibility, some reductions in journey times e.g. from reduction in accidents	Not measured
	Cost			£m (PV Capital Costs)
	System Reliability	Minimise faults and failures and improves system reliability	Defined performance targets	Achievement of BVI targets
	Regeneration	Supports and sustains growth in night-time economy	Lighting improvements prioritised for regeneration projects	Positive
Accessibility	Public transport	Improves accessibility by improving lighting at bus stops, interchange points etc	Number of transport access and interchange points lit to BS 5489	Positive
Integration	Pedestrians	Safer streets encourage pedestrians, promotes And supports range of economic, transport and other social improvement initiatives	Local consultation and survey results	Positive
Cost/Benefits				PVB £m PVC £m BCR

Source – Manchester City Council



Section 4 Developing the Financial Models for the OBC

- 186 The financial appraisal necessary to support the project and procurement options appraisal work will involve the development of financial models to demonstrate that the proposed project is affordable to the local authority and bankable to a potential service provider.
- 187 It is important that the approach to modelling is consistent for each option to enable a like-for-like comparison of project options to be made, along with an assessment of value for money associated with the different procurement options. In particular, care should be taken to ensure that the costs are modelled over a consistent assessment period (some sponsoring departments have defined the period to be used in the appraisal process).
- 188 Each financial model should reflect the anticipated capital investment and operating costs, together with appropriate financial allowances for optimism bias (taking account of HM Treasury guidance) and risk. The cost assumptions underlying the estimates should be consistent across the options, and be clearly set out in the appraisal.
- 189 Cost estimates for each of the different options should be based on the views of the local authority's technical and financial officers and external advisors and (where appropriate) information gathered from potential Service Providers through the soft market testing or deal testing exercise. Schedules should be included, either as part of the financial models or as part of the OBC, in support of the cost data and underlying metrics (such as the unitised costs of specific elements) used in developing the financial models.
- 190 The Green Book includes a concept to take into account the tendency of appraisers to be optimistic in terms of costs, timescales and benefits provided by the options being appraised. To do this, the Green Book recommends the use of optimism bias for capital cost overruns and time overruns, with pre-determined factors relevant for a range of projects identified as a starting point for the new methodology (which should be used until better data becomes available from sponsoring departments). Further guidance is available in *The Outline Business Case* produced by the 4ps.
- 191 Each model should also include appropriate allowances for risk, which is evaluated separately using a risk register. This is to ensure that each of the options is compared on a like-for-like basis, taking full account of the different distribution of risks and responsibilities associated with the different options. Further guidance on developing the risk register for a service scheme is included in Section 6 of this Part of the Procurement Pack.
- 192 Costs should be allocated to the year in which they are expected to occur, and the total cash flows then discounted to a present value using the HM Treasury discount rate.
- 193 The Green Book includes a formula to be used for the evaluation of options in central government appraisal, and local authorities may choose to adopt the same approach. Whatever approach is used, local authorities will need to determine the relevant approach at an early stage, and ensure that this is used consistently.
- 194 A common base year should be used for the purposes of discounting and comparing costs, and the price level and treatment of costs should be consistent across all options. It is usually sufficiently accurate to treat all sums accruing during the course of a year as falling at the mid-year point. PFI projects are expected to use the expected date of service commencement as the base date.



195 For the appraisal of project and procurement options, it is not usually necessary to adjust for general inflation. However, the costs prevailing at the time the OBC is prepared may need to be inflated to reflect the prices that the local authority expects to be in operation at the service commencement date (all financial models should be based on expected prices at the service commencement date). In addition, if any costs are expected to increase at significantly more or less than the general rate of inflation, then these differential changes should be incorporated into the financial models. A view will also need to be taken on the likely price changes in respect of electricity and the costs of service connections.

196 It is not necessary to include any costs in respect of VAT in the financial models for the OBC. Local authorities will, however, need to decide how corporation tax should be dealt with. Where publicly financed options are being compared to a PFI option, the Green Book requires an adjustment to be made to the PSC to reflect the differential UK corporation tax liabilities of traditional procurement when compared to the procurement of a project through the PFI when a Special Purpose Vehicle (SPV) is set up.

Affordability and Shadow Bid Models

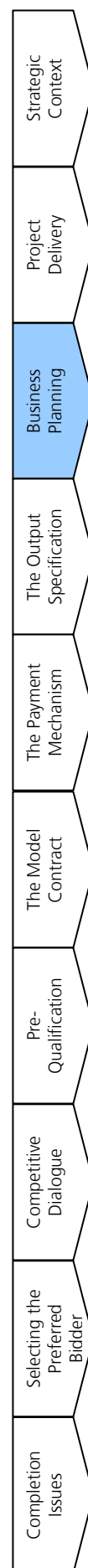
197 There are some important differences between modelling and appraising different project options and assessing the value for money of different procurement options, and establishing whether the local authority can afford the option and ensuring that it is attractive to a potential service provider and its financiers.

198 The purpose of the affordability model is to demonstrate that the local authority will have sufficient cash accruing over the term of the Contract to meet the unitary charge and fund the necessary client-side monitoring costs. The income to fund these costs will accrue from the local authority's service budget, any additional local authority contributions, revenue support from a PFI Credit (if central government financial support is being sought for the project), and from any interest earned on surplus cash balances.

199 The purpose of the bankability model is to demonstrate that a potential service provider is likely to be able to generate sufficient cash to service the debt and equity that will be needed to fund the investment programme. Local authorities seeking central government funding for a PFI scheme are required to use the HM Treasury standard model for this purpose, which incorporates standard equity IRR.

200 The affordability model and computation of the unitary charge for a PFI scheme will need to take account of inflation, and local authorities will need to determine what assumptions to include in the project costs for inflation. At the OBC stage, it may be difficult to judge what assumptions bidders will make as regards inflationary increases, or on what proportion of the unitary charge they will expect such increases. At the business planning stage an assessment will have to be made as to the element of the proposed unitary charge that will be index linked, and at what level. This assessment should be made after appropriate market sounding and/or through discussion with the local authority's financial and technical advisors.

201 Local authorities that are proposing to include benchmarking and/or market testing of 'soft services' or the energy price in their PFI or PPP contracts may need to assess the implications of this on the calculation of the Reference Project. If a local authority proposes to include an allowance in the costs of the scheme for future increases or decreases resulting from a market testing exercise, this will need to be reflected in the financial models.



Detailed Guidance on Financial Modelling

- 202 Worksheet 3 of this Procurement Pack includes a template for each of the OBC financial models for the particular service area. Worksheet 3 is presented as a template using indicative headings for each financial model and local authorities will need to insert the relevant links and formulae. Local authorities are advised to appoint financial advisors with expertise in the service area for this element of the OBC preparation.

The Do Minimum Option

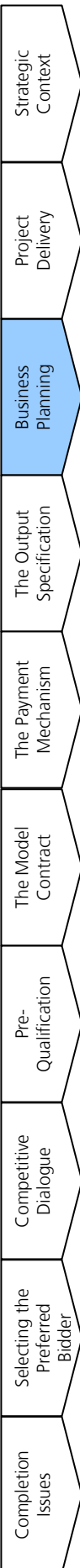
- 203 The financial model for the Do Minimum option provides the local authority with details of the costs of the 'expected' existing service provision and a base case for comparison of other project and procurement options. The Do Nothing option (sometimes referred to as the Continue Existing option) will reflect the costs of the existing service provision. The cost analysis contained within the Do Minimum financial model should be based on 'real' costs indexed by specific inflation in to nominal cash flows; the nominal cash flows should then be discounted to a Net Present Value using the Nominal Treasury Discount Rate adjusted for general inflation.
- 204 An example of the typical components of a Do Minimum model for projects in the service area is shown in Worksheet 3 of this Procurement Pack.

The Public Sector Comparator

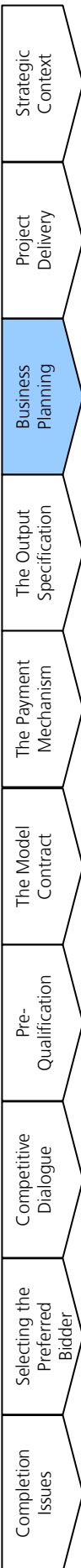
- 205 The PSC prepared for the chosen project option must be costed to the service requirements set out in the draft Output Specification. The PSC will need to be computed using the model included in the HM Treasury *Value for Money Assessment Guidance*. The framework and cost components of the PSC will be similar to the Do Minimum option, with the costs uplifted as necessary, and the service requirements as set out in the draft Output Specification. It is not necessary to include financing costs in the PSC model as they are fully taken in to account of in the Treasury Discount Rate. The PSC should include the costs of the risks retained by the local authority under the traditional procurement route. The NPV of the risks, which would be borne by the local authority under a traditional public sector procurement route but transferred to the service provider under a PFI procurement route, should be added to the capital, lifecycle and operating costs to give a NPV for the PSC.
- 206 The cost analysis contained within the PSC financial model should be based on 'real' costs indexed by specific inflation in to nominal cash flows; the nominal cash flows should then be discounted to a Net Present Value using the Nominal Treasury Discount Rate adjusted for general inflation.

The PFI Option / Shadow Bid Model

- 207 The PFI option will need to be computed in accordance with the HM Treasury *Value for Money Assessment Guidance*.
- 208 In summary, this involves costing the same project option for procurement through the PFI. This financial model will need to set out the costs and risks for delivering the project by a theoretical private sector service provider and will involve the financial advisors having to make certain assumptions about the approach that will be adopted. The approach should be informed by what is being delivered on other projects in operation or procurement, from the market sounding exercise, and using the knowledge and experience of the financial advisors.



- 209 The purpose of the PFI model / shadow bid model is to demonstrate that a potential service provider is likely to be able to generate sufficient cash to service the debt and equity that will be needed to fund the project. This involves establishing a financial model that incorporates the income, operating costs, financing costs and funding structure for a theoretical service provider.
- 210 As with the PSC financial model, this should be based on 'real' costs indexed by specific inflation in to nominal cash flows; the nominal cash flows should then be discounted to a Net Present Value using the Nominal Treasury Discount Rate adjusted for general inflation.
- 211 In modelling a PFI option it is typical to include a financing structure using 90% debt and 10% equity, with the debt being serviced by equal annual payments over the period of the proposed Contract, minus two years (the debt tail), and the equity servicing commencing from the year following completion of the investment programme. Assumptions on capital drawn down should be project specific and based on advice from the technical and financial advisors. Assumptions will need to be made and incorporated into the financial models for financial arrangement fees, commitment fees, development fees, debt service reserve and cost-efficiencies from the PFI approach.
- 212 Operating and lifecycle costs for the PFI Reference Project should be either based on those available from other projects (adjusted for scope and inflation), or on the typical costs for such a project determined from the market sounding exercises with potential service providers, or from experienced technical and financial advisors undertaking detailed work, or from the costs used in the PSC adjusted to reflect relevant private sector assumptions (such as expected efficiencies from the private sector due to improved contracting structures, economies of scale, market proximity and whole-life/whole-service costing techniques). The operating costs should also include specific private sector costs, such as SPV management costs. If taxation allowances are assumed to be available then they should be calculated and reflected in the model.
- 213 The costs of the PFI solution need to be funded by a 'unitary charge' which should be set at a level which provides a robust and bankable financial model (taking into account assumptions such as taxation, debt service ratios and gearing).
- 214 The model should show the Internal Rate of Return (IRR) earned by the equity over the life of the Contract, assuming that the Contract has no value at termination. Dividends should be set at a level that maximises the IRR to the equity funders commensurate with staying within the likely banking covenants, and avoiding running into an overdrawn cash position. The model should also show the Interest Cover Ratio and the Debt Service Cover Ratio for each year of the Contract. The local authority's financial advisors will need to determine what financing ratios should be assumed in the development of the financial models for the particular project.
- 215 If these ratios, and the equity IRR, are insufficient to meet the market expectations at the time, then the unitary charge will have to be increased until they do so.
- 216 In developing the unitary charge a prudent view should also be taken on the LIBOR swap rate and the equity IRR. The NPV of the unitary charge, plus the NPV of the costs of retained client-side management, will be the NPV of the PFI option which is compared with the NPV of the PSC for the purpose of evaluating which procurement option is likely to provide Best Value.
- Affordability model**
- 217 A financial model is also required to show whether or not the local authority can afford the likely costs of the preferred project option under the preferred procurement route. Assuming that the value for money comparison concluded that the preferred option is through PFI procurement, the model will need to compare the income available to the local authority for the

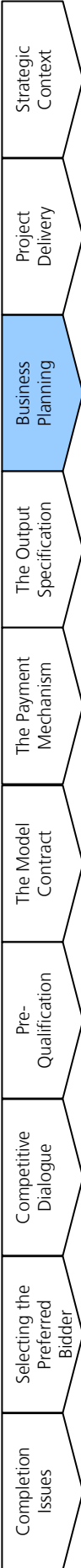


service with the expected unitary charge and other costs. The affordability model effectively reflects the expected cash flows to the local authority of the proposed project.

- 218 The available income is made up of the local authority’s budgets for the service or project, which will need to be inflated at a suitable rate, and the revenue support generated from the PFI credit that is being assumed. The local authority budget that is shown in the affordability model must be supported by confirmation from members that the local authority is prepared to fund the project at this level. As noted in Section 1 of this Part of the Procurement Pack, this confirmation should be included in the OBC.
- 219 The amount of PFI credit assumed in the affordability model will need to be calculated using the relevant departmental guidance. From 1 April 2005, revenue support has been paid on an annuity basis at a prescribed rate determined annually by the DCLG. Local Authorities should ensure that the annuity rate used in the Affordability model is the rate that is judged to be in operation at the time the PFI project is expected to be approved by the PRG, at which point the prescribed rate is fixed for the duration of the revenue support payments.
- 220 The unitary charge used in the affordability model should be the same as that calculated in the financial model for the PFI option.
- 221 Other costs are likely to include the costs to the local authority of monitoring the PFI Contract. These will need to be based on the estimated staffing levels that will need to be in place for contract monitoring and, as with the unitary charge; the costs will need to be inflated at an appropriate level.
- 222 To complete the cash-flow and affordability model, the local authority will need to calculate the expected interest on cash balances (both opening balances and in-year balances), which should be assumed to accrue at a commercial rate, and which will vary from time to time as base rates change. The cash flow is made up of the opening and closing cash balances for each year, and shows the affordability of the project year on year. If this is positive, then the project appears to be affordable, if negative there is an apparent affordability gap and consideration will have to be given to various strategies for resolving this.
- 223 In developing the affordability model, local authorities should not ‘reverse engineer’ to meet a desired affordability gap; the best projects are those that offer a sustainable solution to both the local authority and service provider over the term of the Contract.
- 224 An example of the components of a typical affordability model for a project in the service area is included at Worksheet 3.

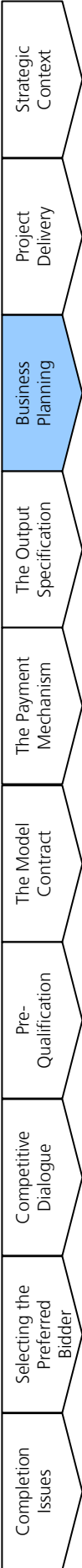
Sensitivity Analysis

- 225 The appraisal of project options will be affected by uncertainty, for example projections of future demand for services may be subject to variation, inflation assumptions will change, cost estimates will change as project details are clarified, and benefits assessments may be subjective and not fully quantified.
- 226 Such uncertainties should be accommodated in the appraisal through sensitivity analysis. This involves identifying the main variables and uncertainties in the options appraisal, assessing the potential range of feasible outcomes, and building those into the evaluation of options. In this way the impact of variability and uncertainty on the relative ranking of options may be tested to identify which options remain robust in the face of potential change. The most robust options



will be those which offer flexibility in the event of change, while retaining their capability to deliver the required outputs in terms of maximising benefits and optimising costs.

- 227 Where small variations change the results of the appraisal, the risks are likely to be significant and will need to be carefully assessed and managed. Risk management action should be focussed on those factors and assumptions to which the results of the appraisal are most sensitive. Any significant differences in the capacity of the short-listed options to respond to risk should be brought out in the OBC.



Section 5 Calculating the PFI Credit for a Street Lighting Scheme

- 228 Local authorities are eligible to seek DfT support towards the costs of new investment in their PPP/PFI street lighting projects. The DfT has produced its own specific guidance on the methodology for funding local authority street lighting projects and a copy of this is reproduced in figure 3.5.1.

Figure 3.5.1 – DfT Method of funding Street Lighting PFI Projects

Most projects aim at a fast track replacement of dilapidated light columns, and inserting new columns to achieve modern lighting levels, in the early years, to obtain the benefits of better lighting quicker. There is nothing wrong with this principle, which in itself suggests that Government support should be based on the first five years' capital replacement costs.

However, to fund these five-year capital costs in full would favour those local authorities who had neglected their lighting stock most over the years. This neglect could be characterised as an approach whereby columns were only replaced when in imminent danger of collapse, and only then when an inadequate budget allowed this, otherwise the column would simply be removed.

All local authorities receive funding for street lighting through Revenue Support Grant, as calculated by the Highways Maintenance Standard Spending Assessment. This is intended to cover capital replacement as well as normal maintenance, but it is not hypothecated. A responsible local authority will use some of this funding to replace lighting units as they reach the end of their projected life, if not sooner if that would reduce whole life costs. This approach can be characterised as the prudent Do Minimum approach.

So an equitable method of funding street lighting PFI projects would be to fund the difference between the capital costs in the Do Minimum case and the preferred option over the first five years (if the preferred option is acceptable in value for money terms, of course). This would avoid local authorities being paid again for work that they should already be doing. It is this method of funding that Ministers have now agreed to.

Applying the Guidance

- 229 To assist local authorities with the calculation of the PFI Credit for a street lighting PFI project, a worksheet has been developed as part of this Procurement Pack (Worksheet 4 – Calculation of PFI Credit).
- 230 This approach takes the capital costs for the preferred option (i.e. accelerated replacement procured through the PFI) for the first 5 years and deducts the capital costs for the Do Minimum option. The capital costs under both the PFI solution and the Do Minimum option are derived from the financial models for these two options and are shown for the first five years of the Contract only. The resulting differences for each year are then discounted using the prescribed rate determined by the DCLG each year to give a NPV, which is the PFI credit that should be assumed.
- 231 There may be other approaches that can justifiably be used to compute the PFI Credit for a street lighting project and local authorities must take appropriate advice on this matter.
- 232 Local authorities requiring further information on the calculation of PFI Credits and the revenue support for local authority PFI projects should refer to the guidance produced by the 4ps *The Outline Business Case*, available from the 4ps website and the annual guidance produced by the DCLG.

Strategic
Context

Project
Delivery

Business
Planning

The Output
Specification

The Payment
Mechanism

The Model
Contract

Pre-
Qualification

Competitive
Dialogue

Selecting the
Preferred
Bidder

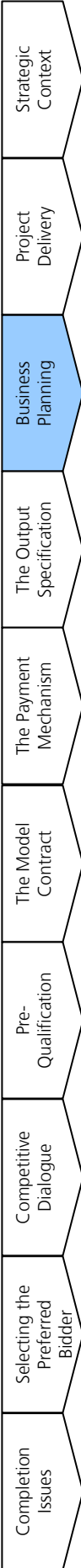
Completion
Issues

Section 6 The Risk Register

- 233 All projects are subject to uncertainty and risk. The risk that project outcomes will not match project objectives needs to be recognised from the earliest stages of business planning, and suitable risk management responses developed.
- 234 The appraisal of options should include a thorough assessment of the risks associated with a project, with the basic principle being that value for money is most likely to be obtained when risk is assigned to the party best placed to manage that risk. The aim should be to achieve the optimum allocation of risk.
- 235 Different service delivery options will have different risks, for instance capital programmes costing more than forecast or over-running; operating costs exceeding forecasts; efficiency savings not being achieved; and third-party income not materialising.
- 236 Identifying and evaluating these risks at an early stage in the development of the project will allow a proper comparison of the costs and benefits of the various project and procurement options which, to be realistic, must include the expected value of the risks associated with that option. In quantifying the risks associated with each option, it must be assumed that each procurement option will deliver the same outputs and outcomes, as defined in the Output Specification, to enable a like-for-like comparison.

Identifying the Project Risks

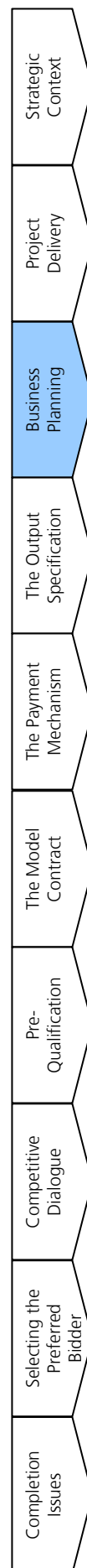
- 237 The first stage in this process should be to identify all of the risks associated with the delivery of the service or project and to record these on a 'Risk Register'. A separate Risk Register should be compiled for each of the project and procurement options under detailed consideration, as the profile of the risks will alter according to the specific details of the option. In preparing a Risk Register, it can be helpful to analyse the risks identified over the key stages of the project, such as development, design, build (or installation or refurbishment), financing and operations. Risk allocation columns should be used in the Register to indicate which party is expected to bear the risk under the various project and procurement options being appraised.
- 238 The technical and financial advisors should be responsible for, or lead the work on, the identification and analysis of project risks. The Risk Register developed as part of the business planning work and used as a basis in the appraisal of options and for the financial models, should be included as part of the OBC.
- 239 A template Risk Register for the service area has been developed for this Procurement Pack (Worksheet 5 – Risk Register). This template is based on the Risk Registers developed for a range of different types of PFI/PPP projects being developed in the local authority sector and is intended only as a starting point for local authorities developing the OBC Risk Register for a project in the service area. It is important that the local authority carefully assesses the template against local circumstances and ensures that the Register properly reflects its requirements. The local authority should involve all members of the project team, including its external advisors and risk management officer, in this exercise; this approach has the advantage of bringing all members of the project team up to speed on the identification and allocation of risks in the various project and procurement options.



240 In assessing the allocation of risk under the various procurement options, it is important that for the PFI option the allocation of risk is consistent with the approach set out in the HM Treasury guidance *Standardisation of PFI Contracts*, and with the Sector Specific Contract developed for projects in the service area. Further guidance on contractual issues is provided in Part Six of this Procurement Pack.

Quantifying the Risks

- 241 Once the risks have been identified and allocated to the party best able to manage those risks under each project and procurement option, the next stage is to quantify the **material** risks relevant to each project and procurement option so that an appropriate cost can be built into the financial models and options appraisal exercises.
- 242 The basis for calculating the impact of the risk will need to be documented and the assumptions tested. The quantification should show the likely cost to the project option of the risk materialising. This should be based on a technical assessment of the project risks, and be informed by data available from other service projects, from the local authority's historical experience, and from the market sounding exercise. In many cases the cost of the risk can be derived from an element of the project costs, multiplied by a factor. For example, the risk of capital cost overruns could be based on a factor of the costs of the capital investment, and the risk associated with energy provision may be related to the expected costs of energy supply.
- 243 There are various tools that can be used as part of this quantification exercise, such as probability analysis, risk impact analysis and Monte Carlo analysis, and the local authority should determine an approach that is relevant to local circumstances and the size and complexity of the project being developed.
- 244 For capital expenditure and time overruns the risk quantification should take account of the allowance made for optimism bias.
- 245 An example of an approach used for risk quantification (using probability analysis to quantify the risks) is included as part of Worksheet 5.
- 246 If a probability assessment is to be used for the quantification of risk, this should show the estimate of the percentage probability of the risk occurring in the project. This can be any percentage between 0% (will never happen) and 100% (will always happen). The percentage used should be informed by a technical appraisal of the project, by reference to historical experience and from information available from other service projects in operation or procurement.
- 247 In probability analysis, the expected cost of the risk is obtained by multiplying the impact of the risk by the probability of the risk occurring. The NPV of the expected cost is obtained by reference to the time frame in which the risk is likely to materialise, calculated by taking the mean year of this 'at risk period'.



**STREET LIGHTING
PROCUREMENT PACK
PART FOUR
THE OUTPUT SPECIFICATION**

Strategic
Context

Project
Delivery

Business
Planning

The Output
Specification

The Payment
Mechanism

The Model
Contract

Pre-
Qualification

Competitive
Dialogue

Selecting the
Preferred
Bidder

Completion
Issues

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Purpose of the Output Specification

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Key Features of the Output Specification

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Key points for a Street Lighting Scheme

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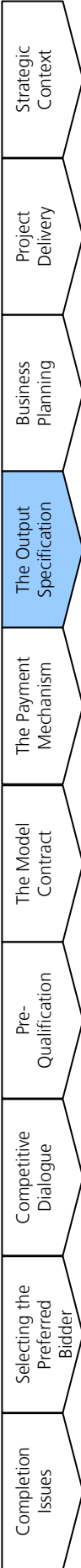
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Also relevant to this Part Five of the guidance is:

- **Model 1 – Output Specification**



Section 1

Purpose of the Output Specification

What is an Output Specification?

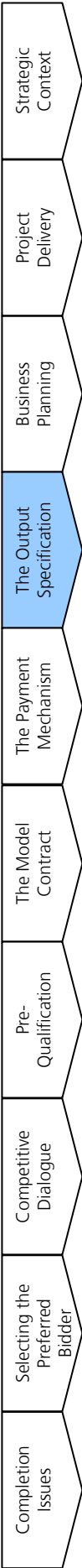
- 248 The Output Specification is arguably the most important document in the procurement of a project through the PFI or a PPP. It is the basis through which the local authority defines the services and outputs that it requires from the service provider for the term of the Contract. Since a well-developed draft of the Output Specification is required for the business planning process and development of OBC, consideration must be given to the development of the Output Specification at an early stage.
- 249 The Output Specification should aim to detail **what** needs to be achieved not **how** it is to be achieved. What is **not** wanted should also be specified to ensure that all areas have been covered. Such generally framed outputs however cannot in themselves guarantee that the appropriate services will be delivered. Specificity comes from defining appropriate performance targets for each of the outputs or outcomes required.

Why an Output Specification?

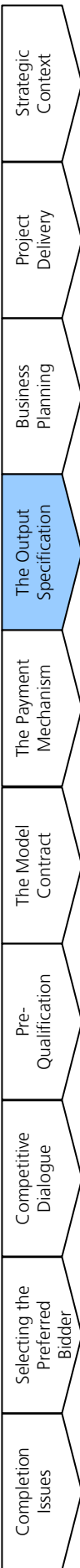
- 250 A well-drafted Output Specification is fundamental to developing a robust PFI or PPP Contract and the successful delivery of long-term services. It is part of a process that is radically different to traditional procurement, in that the emphasis is on affordable service outcomes and outputs, the explicit allocation of risks, and the integration of design and build with the operation of the services.
- 251 In comparison, conventional procurement methodology is often an iterative process in which an outline of the project is drawn up and costed. Further iterations and costing revisions normally occur before a final scheme is agreed and the Contract for development is let. Using this process, the risks of cost increases and failure due to issues such as inappropriate design tend to fall on the local authority. As a result, the completion of the project can be delayed; it can cost more than originally anticipated, or can fail to meet all of the initial objectives. Additionally, little account may be taken of ongoing running costs in terms of life-cycle maintenance, the ongoing provision of services, and the efficiency of the service provision.
- 252 Developing a specification in terms of outputs is likely to encourage a focus on strategic needs and future service requirements, rather than the history and detail of current provision. A well-produced Output Specification should allow the introduction and development of new ideas about the design, installation and operation of the service. Most critically, because the approach encourages bidders to develop the means to deliver the outputs within the context of a fixed, performance-related pricing mechanism, it focuses much more attention on project risks. This should lead to a better-designed and operated service over the whole life of the proposed project.

Stimulating innovation

- 253 As well as encouraging innovation in design and operational methods, the PFI process also offers scope for innovation. New forms of teamwork may well develop amongst bidding consortia, with the potentially creative synergy between designers, contractors and operators kick-starting innovative ideas. In addition, the PFI approach should encourage bidders to focus more sharply on ideas and solutions that will optimise the whole-life-cost of the project.



254 PFI presents a challenge to bidders to deliver an improved service. This challenge can only be met effectively if the local authority is clear about its requirements, and communicates these in a way that allows bidders to develop the optimal solution. Hence, bidders need to be able to work to a well-written Output Specification from the outset of the PFI procurement process.



Section 2 Key Features of the Output Specification

What constitutes a good Output Specification?

255 Producing an effective Output Specification involves the art of defining the end without specifying the means. Outputs should clearly and comprehensively state what is required, and the standards to be achieved. In summary, a good Output Specification must:

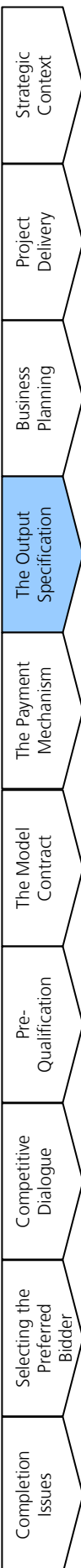
- Reflect the local authority’s corporate and service policy objectives
- Be clear, concise and unambiguous
- Give the potential bidders sufficient information to decide and cost the solutions they will offer
- Take account of the need for compliance with legal or other statutory requirements and policies, and any compatibility requirements
- Specify any constraints that are essential to defining a deliverable solution; for example corporate practices. These should distinguish between mandatory and other constraints
- Permit solutions to be evaluated in the procurement process against defined criteria
- Identify those functions or aspects of the service that are critical to the performance of the service and which, therefore, will be given most weight in the Payment Mechanism
- Only contain requirements that can be afforded by the local authority and are deliverable.

256 In essence, a good Output Specification must communicate what is expected from bidders, leaving them room to produce innovative, cost-effective solutions to the clearly specified needs and requirements of the local authority. Statutory requirements may differ according to whether they apply to existing or new services. Care should be taken to ensure that bidders are clear on these issues, and that over, or under-specification, does not unwittingly occur.

Risk transfer

257 The Output Specification, by defining outputs, necessarily defines many of the risks that the bidders are being asked to take on. It is for the bidders to assemble the optimum means of delivering the services required and meeting the outputs specified, and they do this at their own risk of failure. If the services fail in some way, the local authority cannot be blamed if it has had no responsibility for suggesting how those services are to be provided, and has effective recourse through the Payment Mechanism.

258 For example, if a service provider installs an innovative aspect of service delivery (at perhaps higher cost than the local authority might have been able to afford on its own), it should be able to deliver the stated outputs more cost-effectively over the life of the Contract. Because the service provider has made this decision, not the local authority, it is the service provider that takes the consequences of running costs being greater than anticipated. No approval by the local authority, or agreement as to details, absolves the service provider from its contractual responsibility.

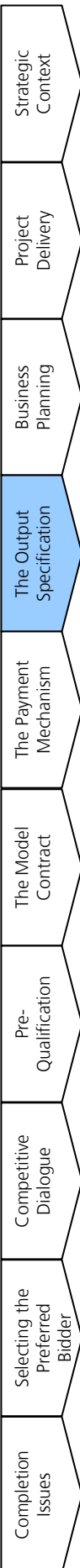


Performance targets

- 259 The Output Specification should clearly define the performance targets of the services to be achieved. Without clear targets, the Output Specification will be open to misinterpretation in terms of the required service levels, and therefore cost. In addition, it may be more difficult to compare and evaluate bidders' responses if service standards and requirements have been misinterpreted.
- 260 A lack of clarity in the Output Specification will also make it harder to build up the PSC and Reference Project, making Best Value more difficult to establish. Both the PSC and Reference Project must be consistent with the Output Specification so that the comparison is on a like-for-like basis (see also Part Three of this Procurement Pack). Enhanced standards are sometimes specified in the Output Specification, whilst the PSC is only costed at traditional standards, with risk transfer allowances inflated to mask the difference. This does not provide a good basis for establishing value for money or for evaluating bids.
- 261 More detailed guidance on setting performance targets is given in Part Five of this Procurement Pack.

Managing the risks of changing standards

- 262 The Output Specification needs to be drafted so that the emphasis is on the service provider keeping pace with changing standards. How the risks and rewards of such changes are reflected in the unitary charge should be part of competitive dialogue. The approach may well vary according to the nature of the risk. For example, some of these risks will fall within the generic definitions of general legislative risk, whilst others will have to be separately identified and catered for.
- 263 In determining how such risks should be managed, a balance needs to be struck between providing incentives to the service provider to continue providing the same service levels, and value for money. Sufficient incentives should be developed to encourage the absorption of any additional costs arising from changing standards, without transferring so much risk that the service provider will try to recover the possible costs indirectly, whether or not they occur.
- 264 In some instances, it may be better value for money to share the risks of changing standards. This may be done in a number of different ways, which include one or more of the following:
- A formula
 - Capping the costs of change to both the local authority and the service provider
 - Discussion at the time of the occurrence of the change within a pre-agreed framework
 - Both the local authority and the service provider bearing the risks at different points in the Contract.
- 265 Whilst it is important to specify that services must be capable of improvement and modification in the future (such as following a CPA or Best Value Review), local authorities should take account of the fact that complete flexibility is likely to be very expensive and counter-productive

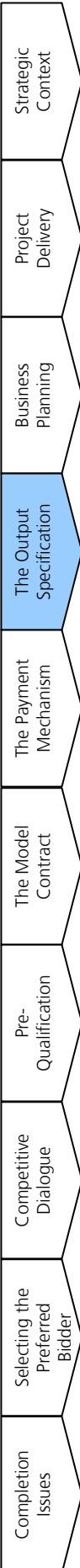


Compliance with Performance Standards

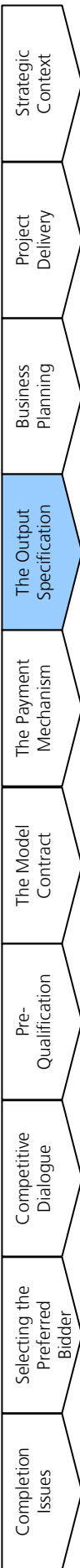
- 266 The Output Specification must dovetail with the local authority's Payment Mechanism. The Service Provider will be expected to bear the risk of sub-standard performance against the agreed performance targets. If lower targets are achieved, lower payments will be made. Clearly, there also needs to be a mechanism so that if the service falls below certain given levels, further consequences follow, for example, service points and ultimately termination for service provider default (see also guidance on developing the Payment Mechanism in Part Five of this Procurement Pack).
- 267 A practical form of performance monitoring needs to be agreed which minimises the potential for disputes and which is not expensive or excessively time-consuming for the local authority or the service provider.
- 268 As part of the bidders' response to the Invitation to Submit Detailed Solutions (ISDS), local authorities should seek details of the bidders' solutions for performance monitoring and quality management in order to demonstrate how the delivery and continuity of services are expected to be achieved over the life of the Contract. Ultimately, the onus should be on the service provider to develop a self-monitoring system, with the local authority requirement being for exception reporting and the audit and inspection of such arrangements.
- 269 As part of developing the ISDS, the local authority will need to make sure that the Output Specification, monitoring arrangements and Payment Mechanism will interact with each other.

Bidders' responses to the Output Specification

- 270 Local authorities will need to determine, as part of developing the Output Specification and ISDS, what information will be required from bidders as part of the bid submission. It is likely that such information will fall into two categories:
- Information that will be used as part of bid evaluation only
 - Information that will be used for bid evaluation and will also become contractual (i.e. will be inserted as schedules to the Contract).
- 271 4ps suggests that this is done through:
- Requesting contractual Method Statements (sometimes collectively encompassed in a Service Delivery Plan) that will become a schedule to the PFI Contract. For example, bidders' responses on monitoring should become a contractual Method Statement, since these will form a link between the Output Specification and Payment Mechanism
 - Requesting Method Statements on other aspects of the service that will form an important part of the technical evaluation process, but will not become contractual.
- 272 Examples of the information sought as part of the ISDS for a service project are included in Model 11 of this Procurement Pack – ISDS - Instructions and Guidance to Bidders.



- 273 Local authorities should aim to seek Method Statements that demonstrate how the services are to be provided and delivered at the required standards, and it is important that the ISDS makes clear the level of detail required. In order to cost bids properly, bidders will need to develop a high degree of detail in terms of their Method Statements for the manner in which they intend to provide and deliver the services. The technical evaluation and due diligence process will need to appraise the bidders' solutions and responses, and the local authority will need to assess the effectiveness and deliverability of the solutions proposed.
- 274 There will undoubtedly be aspects of the Output Specification that need clarification and fine-tuning during the competitive dialogue process. Clarification meetings (competitive dialogue) with the bidders between the issue of the ISDS and the date for return of their detailed solutions are therefore vital to avoid 'blind alleys'. The clarification meetings are a useful way of ensuring that bidders address those Output Specification-related aspects of the ISDS in the right level of detail, and in a way that allows robust technical evaluation and financial appraisal. Any changes to the Output Specification as a result of the clarification and fine-tuning meetings must be made available to all bidders.
- 275 Information should not be drip-fed to bidders in such a way that it makes it difficult to respond effectively. Bidders need to know, from the outset of the procurement process, how the Output Specification will be fine-tuned at each stage of the process. Ideally, a fully worked up Output Specification should be developed at the business planning stage.
- 276 Background information about existing facilities and services should be provided in a Data Room or through a collaborative website, but care should be taken not to warrant this information. Sufficient background data on the local authority's relevant policies and strategies should be included in the Data Room or on the collaborative website to allow bidders to place the project in context, and to stimulate innovation.
- 277 Surveys of the condition of existing facilities and assets are often made available to bidders, but care needs to be taken over their status. Pre-existing survey data may not match the scope of the Output Specification, and bidders are unlikely to accept newly commissioned surveys if they are expected to take latent defect risk



Section 3 Developing the Output Specification

Who produces the Output Specification?

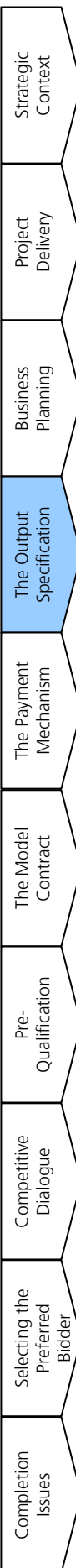
- 278 In developing the Output Specification, local authorities should be able to draw on their experience of standard setting in other tendering exercises. Technical advisors will need to be appointed to assist if appropriate in-house expertise or resources are not available.
- 279 The production of the Output Specification must not be left solely to advisors, but should involve all members of the project team and other relevant stakeholders. Involvement and discussion of the outputs required is likely to result in wider ownership of the end product, and thus contribute to a better partnership.

How to prepare the Output Specification

- 280 Local authorities are adopting a number of approaches to developing the Output Specification. It is suggested that the most effective approach is to use the model Output Specification included in this Procurement Pack (Model 1 – Output Specification) as a starting point, and to use facilitated workshops to refine and develop the Output Specification to ensure that it meets local circumstances and service delivery arrangements, and the local authority's own particular needs.
- 281 Workshops involving the project team and other relevant stakeholders provide a vehicle for engendering shared ownership of the end product and for achieving consensus on realistic, affordable outputs. It can be helpful to use a facilitator (with the appropriate skills and experience) for these sessions. An informed and experienced facilitator may encourage more lateral thinking while providing the necessary focus, and act as broker to reconcile any differences. When running a workshop, local authorities may choose to use some initially drafted thoughts (such as the model included in this Procurement Pack) as a basis for the discussion, and 'workshop' the development of both the Output Specification and Payment Mechanism alongside each other. Alternatively, local authorities may choose not to do any preparatory work, but to start from a blank piece of paper.
- 282 Another approach, but one that is compatible with the use of workshops, is to start off with the existing service (input) specification and convert it into output requirements. At the outset it may be easier for many of the stakeholders to think in terms of inputs and this may therefore be a suitable way of kick-starting the Output Specification process. Care must be taken, however, to ensure that the end product does not retain unnecessary or unsuitable inputs.
- 283 Stakeholders need plenty of time to develop their understanding of PFI and PPP and to work on their contributions to key documents such as the Output Specification. Local authorities should not underestimate the amount of time that is required for these purposes

Inputs versus outputs

- 284 A totally purist approach to drafting the Output Specification, which could leave bidders second-guessing what is wanted, should be avoided. Such an approach may leave to chance (and therefore error) the more detailed aspects that are seen as absolutely non-negotiable by the local authority.



285 Pragmatic compromises can be made as to the balance between the inputs and outputs, and the parameters and standards specified. In moving away from outputs, the local authority needs to consider whether the change in emphasis materially compromises risk transfer; stifles creative thinking; limits future changes; or potentially affects Best Value.

Determining and defining outputs

286 The following questions provide a useful framework for determining and defining outputs:

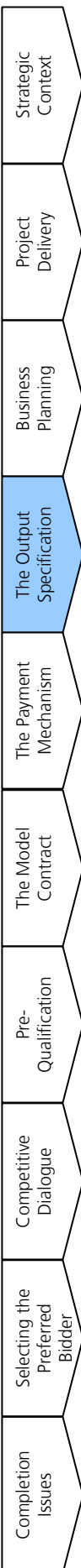
- What are the objectives of the services to be provided?
- How can these objectives contribute to the successful delivery of the service?
- In the light of these objectives, what is definitely not wanted?
- What is open to competitive dialogue?
- What is the standard and level of service that must be delivered?
- What is desirable over that level and standard, if affordable?
- What service parameters are immutable / discretionary?
- How do services and outputs rank in terms of functional criticality?
- What is likely to change over the life of the Contract and what are the potential drivers? How can such changes be allowed for in the Output Specification?
- Is it possible to translate the specified standards into performance measures within the Payment Mechanism?

Phasing and timing of developing the Output Specification

287 A well-developed draft of the Output Specification should be produced at the OBC stage to provide a guide to developing the key principles, objectives and requirements of the project, and to inform the financial modelling of the project and procurement options. The draft Output Specification should reflect the outcome of any market-sounding exercise.

288 A succinct summary or outline of the Output Specification should be incorporated in the Descriptive Document, for issue as part of the pre-qualification stage of the procurement process (dealt with in Part Seven of this Procurement Pack). The Output Specification should then be fine-tuned following the initial competitive dialogue (short-listing) stage, taking into account any further ideas generated during the short-listing process, and incorporated into the version issued as part of the ISDS.

289 It is acceptable to fine-tune the Output Specification following issue of the ISDS documents, taking account of views received from bidders. The overall form and approach, however, must not change significantly because of the need to comply with the Procurement Regulations in terms of fair and transparent competition.



Section 4

Key Points for a Street Lighting Scheme

290 Set out below is guidance on the key issues to be borne in mind in developing the Output Specification for a street lighting scheme. This Output Specification guidance should be read in conjunction with the contractual guidance included in Part Six of this Procurement Pack.

Output Specification Structure

291 The Street Lighting Output Specification is a schedule (Schedule 2) to the Project Agreement. It allows the authority to specify a series of required outcomes and performance targets relating to installation, maintenance and management of the street lighting service.

292 The Output Specification that is normally adopted for street lighting PFI consists of a several sections defined as PS's. Each PS has been developed in a manner that allows the authority to specify required outcomes, service delivery, performance requirements and measurement criteria in respect of each part of the Service. The requirements of the PS's should correspond and align with the legal and financial requirements specified within the Contract.

293 The main body of the Output Specification consists of the following sections:

- The Service
- PS1 - Investment Programmes.
- PS2 - Planned Maintenance, Inspection and Testing.
- PS3 - Operational Responsiveness and Reactive Maintenance.
- PS4 - Contract Management and Customer Interface.
- PS5 - Strategic Assistance and Reporting.
- PS6 - Working Practices.
- PS7 - Reporting to the Authority.
- PS8 - Post Core Investment Programme Period (optional see footnote within the model Output Specification).

294 Each section will need to be considered in detail by the authority during development preparation of the Output Specification.

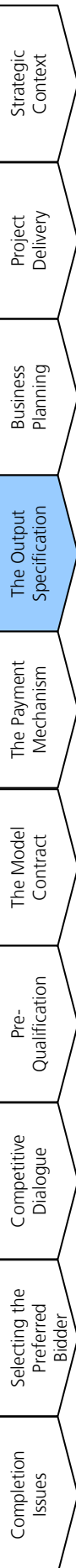
295 The text that follows in this section has been prepared so that the reader can gain an overall understanding of the format used within the Output Specification and the specific sections therein.

The Service

296 This section of the Output specification allows the authority to provide input with respect to identification of the core aims and objectives of the project and defining the scope of the service. The Authority and its advisors should review this section and align the text with the project specific requirements of the Authority.

PS1 - Investment Programmes

297 This PS specifies the service levels expected with respect to any design and installation works executed during the life of the project. It allows the authority to confirm scope with regard to Apparatus replacement and define light level requirements specific to the authority's own



needs. To do this the authority will need to develop “Specific Lighting Design Standards” for the project and insert the details within Appendix C (Specific Lighting Design Standards). A sample appendix C has been included within the model Output Specification.

298 To date, the approach taken has been to specify equipment ‘standards’ expressed either in terms of:

- Lighting classes.
- A common design specification (typically expressed in terms of BS 5489).
- A design life.
- Other specific standards or outputs (for example the IP rating system in relation to luminaires, colour rendering indices/temperatures in relation to light sources).

299 This approach leaves the service provider with a range of choices regarding the design solution, the choice of materials, the suppliers and whole life costs of equipment used.

300 Care must be taken in developing the Output Specification to not be prescriptive in specifying the equipment to be used in different locations, as this will limit innovation and the extent of risk transfer. There may, however, be special circumstances, due to planning, conservation or other restrictions where a specialist solution needs to be adopted. Such requirements should be limited to exceptional circumstances.

301 Local authorities need to ensure that the equipment standards specified are realistic in relation to the cost estimates contained within their analysis of the affordability of the core investment programme and on-going life cycle replacement programmes, and that the Output Specification and Contract manages risks at hand-back effectively.

302 In preparation of the project specific information for this PS the Authority and it’s advisors will also need to consider the following:

- Details of any additional lighting within selected unlit areas, Appendix A (Unlit Back Streets, Roads, Footpaths and Other Areas).
- Details of any project specific apparatus upgrades and Modifications in selected areas, Appendix B (Project Specific Apparatus Upgrades and Modifications).
- Details of the Authority’s policy with regard to Private Cable Network, Appendix E (Private Cable Network Requirements).

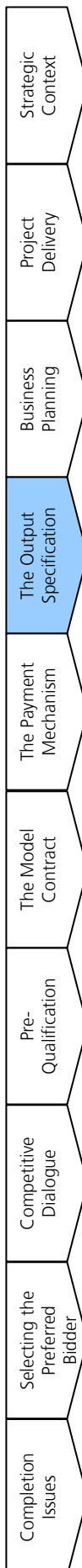
303 Although the primary function of PS1 is the specification and measurement of the service provider’s performance during the initial investment programme (Core Investment Programme), which is normally the first 5 years of the project, it should be noted that the technical requirements of PS1 apply to all installation works during the contract term.

PS2 - Planned Maintenance, Inspection and Testing

304 This PS specifies the service levels expected with respect to any planned maintenance, inspection and testing executed during the life of the project.

305 The service delivery and performance requirements detailed within this PS relating to routine maintenance, inspection and testing include:

- Lighting Performance.
- Bulk Lamp Change and Clean regimes.



- Remote Monitoring Equipment Maintenance (existing authority equipment and any installed by the service provider).
- Outage Detection cycles.
- Structural and Mechanical.
- Electrical Inspection.
- Planned Inspection and Testing, Protective Paint System Inspection and Testing.

306 In preparation of the project specific information for this PS the Authority and it's advisors will also need to consider the following:

- If available the authority should insert details of any trees under preservation orders within Appendix F (Tree Preservation Orders).
- Requirements with respect to the bulk change and clean frequencies applicable to deemed to comply apparatus in Appendix G (Deemed to Comply Apparatus, Bulk Change and Clean Frequency).
- The authority should insert an appropriate % within the performance target for Lighting Points shall be In Light during the Lighting Up Periods.

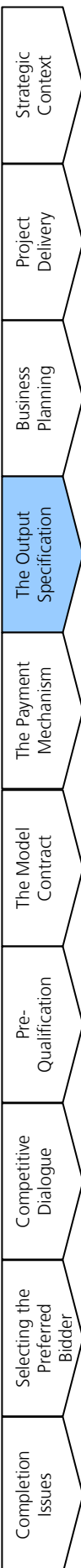
307 In developing the Output Specification, the local authority will need to consider not only how to specify but also how to measure the lighting performance actually delivered by a service provider. The approach used should aim to combine a regular, planned regime to inspect whether each lighting point is working as planned, with a test to confirm whether the light is delivering an output in accordance with its design thresholds. In the model Output Specification (Model 6 of this Procurement Pack), this has been done through the use of two 'components' to PS 2:

- Lighting points working as planned – This should be a planned regular test to establish whether individual lighting points are working in accordance with their intended 'lighting up' periods. The 'lighting up' period is typically defined, either in accordance with the configuration of specified lighting up periods or the design of lighting controls. The approach to inspection should be left for bidders to specify (in a contractual Method Statement), but is likely to be through either visual checks (by patrolling or scouting) or through the use of technology, such as intelligent control gear or remote monitoring.
- Lighting Outputs – There is no doubt the purest output is the measurement of the actual light delivered on to the streets in comparison to the relevant design specification (such as through the use of a field based photometric test).

308 There is controversy among lighting engineers as to whether the photometric output of lighting in the field can be accurately measured in practice, and the concern that actual performance can be subject to a range of external factors (for example light spill from surrounding buildings and inclement weather). This has been dealt with in the model Output Specification and Payment Mechanism Schedule in this Procurement Pack through the use of a 'buffer' within the performance target to ensure that the service provider is not penalised for 'near misses'.

309 Due to these perceived difficulties, some local authorities have accepted a less pure approach and are relying on the monitoring of planned maintenance interventions, and the maintenance factors applied in the design process (in effect a desk-top simulation of the photo-metric performance of the lighting). If this approach is to be used, the performance targets should be set at a higher level, as this approach does not take account of the external factors.

310 The approach taken will ultimately be based upon the local authority's views on the validity of field-based photometric testing. The model Output Specification assumes that a field based photometric test will be adopted and that the local authority will require bidders to submit a



contractual Method Statement that outlines the approach by which the photo-metric performance of lighting will be measured. Model instructions for such a Method Statement are included in Model 9 – ISDS Instructions and Guidance to bidders.

PS3 - Operational Responsiveness and Reactive Maintenance

311 This PS specifies the service levels expected with respect to responding to faults generated in response to apparatus failure or third party damage. The service delivery and performance requirements within this PS place faults into two distinct categories defined as Emergency and Non- Emergency Faults. The Authority should review the content within table 3 of this PS and modify the descriptors and timescales, if required, to suit the project specific requirements.

PS4 - Contract Management and Customer Interface

312 This PS specifies the service levels expected with respect to the contract management and customer care service. The PS specifies the requirements for the development, operation and maintenance of key contract management systems. The systems are defined as the Management Information System, Customer Care System and Geographical Information System. The Authority should review the content within table 4 of this PS and modify the descriptors and timescales, if required, to suit the project specific requirements.

313 The authority should insert project specific data set requirements into Appendix H (Apparatus Data Sets).

PS5 - Strategic Assistance and Reporting

314 This PS specifies the service levels expected with respect to the service providers obligation to provide relevant, accurate and timely information on its technical performance in relation to the Services in the form of Monthly Service Reports and Annual Service Reports.

315 This PS also deals with customer satisfaction surveys and reporting of key and local performance indicators.

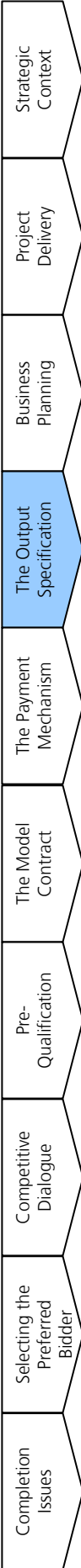
316 In preparation of the project specific information for this PS the Authority and it’s advisors will also need to consider the following:

- Performance Indicators into Appendix I (Performance Indicators).
- Monthly Service Report Templates in Appendix Q (Service Report Content).
- Annual Service Report Templates in Appendix Q (Service Report Content).

PS6 - Working Practices

317 This PS specifies the service levels expected with respect to the working practice adopted by the service provider in relation to the following:

- New Roads and Streetworks Act.
- Health and Safety.
- Waste Disposal and COSHH.
- Environmental Management.
- Quality Management.
- Working Hours and Nuisance.
- Protester Action.
- Access.



- Service Provider Personnel.
- Department of Personnel.
- Corporate Identification.
- Services for Third parties and Recovery of Debts.
- Festive Lighting.

318 The requirements relating to the majority of the working practices listed above should be fairly consistent between Authorities. However, it is recommended that the authority review the model drafting that relates to NRSWA and festive lighting.

PS7 - Reporting to the Authority

319 This PS specifies the service levels expected with respect to the service provider reporting financial performance against PS's PS1 to 6 (and 8 if applicable to the specific project).

PS8 - Post Core Investment Programme Period (optional see footnote within the model Output Specification)

320 This PS specifies the service levels expected with respect to any Post Core Investment Programmes identified by the authority. This standard should only be used if the authority decided during development of the Outline Business Case that some of the Apparatus should be Temporary Deemed to Comply.

Costing the Specification and the avoidance of 'Betterment'

321 In developing the Output Specification, care must be taken to ensure that the local authority is not unintentionally specifying too high a level of service. Unless the local authority is very clear about service standards and the relationship of those standards to service costs, then 'betterment' can be a problem and lead to affordability issues. Local authorities need to recognise that the development of the Output Specification is not an opportunity to generally drive up standards of service without a full appreciation of the associated cost implications.

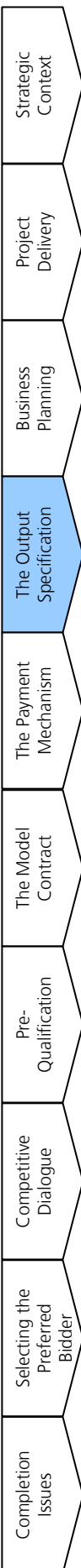
322 Local authorities need to ensure that there is a read across from the assumptions contained within the Output Specification, to the local authority's budgets and the approach that a service provider will take to the costing of service delivery arrangements within a long-term performance Contract. Particular care must be taken in relation to the coverage of the investment programme, the condition of the existing infrastructure, the lighting design standards specified and the relationship to existing lighting design standards, maintenance response times and inspection/testing frequencies, customer care and recording standards.

323 Local authorities need to appreciate that a service provider's approach to costing the Output Specification within the context of a long-term performance Contract will vary from the approach taken in relation to a traditional term maintenance Contract where the local authority retains the majority of the risks associated with service delivery.

324 Local authorities are therefore encouraged to undertake a thorough costing of the Output Specification as it develops and to critically evaluate this in the context of available financial resources.

Method Statements

325 Local authorities should aim to seek Method Statements that demonstrate how the services shall be provided and delivered at the required standards, and it is important that the ISDS makes

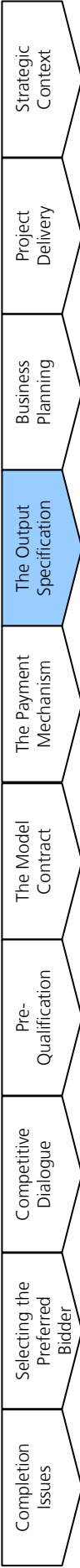


clear the level of detail required. In order to cost bids properly, bidders will need to develop a high degree of detail in terms of their Method Statements for the manner in which they intend to provide and deliver the services. The technical evaluation and due diligence process will need to appraise the bidders' solutions and responses, and the local authority will need to assess the effectiveness and deliverability of the solutions proposed.

- 326 The model Output Specification included in this Procurement Pack makes reference to a range of contractual and non-contractual Method Statements. These Method Statements are 'bid' back to the local authority as part of the procurement process and are evaluated and developed as the procurement proceeds. The local authority's requirements for Method Statements will need to be developed as part of the ISDS and the relevant requirements set out in the Instructions and Guidance to bidders (see Part 7 of this Procurement Pack). In a range of areas, the methods by which the service provider achieves the PS's defined within the Output Specification will be unique and, therefore, the systems for Contract monitoring need to be developed within this context. The Method Statements will need to provide the link between the Output Specification and the service provider's solution, and provide the basis of systems for Contract monitoring.
- 327 The use of Method Statements in this manner means that the most innovative service solutions can be identified and developed by the service provider. However, great care and diligence must be taken in evaluating the service provider's proposals to ensure that they act as an effective 'extension' to the local authority's service requirements and that any 'gaps' are identified and negotiated as the procurement process develops.

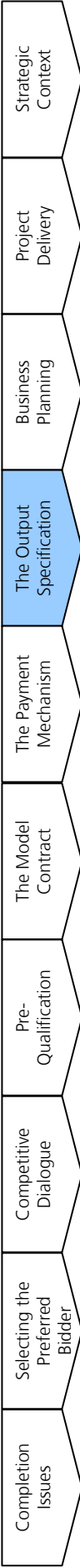
Structural Integrity Standards and Intervention

- 328 The relevant standards outlined in the model Output Specification do not include standards for the structural and mechanical integrity of the lighting infrastructure, other than at the time of installation. This is because the specification and objective measurement of such standards operationally is considered to be too difficult. This is not only because structural and mechanical safety standards may be specific to particular lighting designs, but also that the testing routes to objectively measure safety either involve the destruction of the asset or are costly to undertake.
- 329 This therefore raises the issue as to how the service provider is incentivised to undertake works to ensure the structural and mechanical integrity of the lighting infrastructure throughout the period of the Contract.
- 330 As the service provider is liable for any damage/injury caused through failure of the lighting Apparatus and the benefits from whole life costing efficiencies, there is a built-in incentive to manage the assets safely and efficiently. In addition, the service will have a range of obligations in relation to the hand-back and residual life of assets at the end of the Contract period.
- 331 However, to protect the local authority from the service provider storing up risks in the later years of the Contract, through a failure to replace the Apparatus on a programmed and safe basis, there should also be financial and contractual mechanisms to incentivise the service provider to manage this risk effectively. This is particularly the case where the service provider has made extensive provision for life-cycle replacements during the later years of the Contract.
- 332 In order to provide the best protection to the local authority, the Output Specification should provide for the equipment design and installation standards to apply throughout the Contract period and should ensure that an appropriate standard of equipment is used throughout. The Output Specification and payment mechanism should also incentivise the service provider to manage the asset safely through a range of maintenance based targets and obligations. In particular, the planned maintenance obligations in respect of the Apparatus should require the



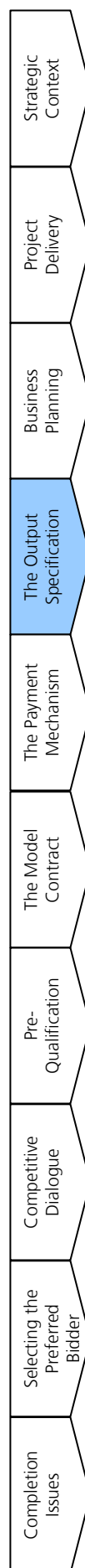
service provider to cyclically inspect the structural mechanical and electrical integrity of the Apparatus.

- 333 Whilst the method of inspection should be left to bidders (and ultimately form a contractual Method Statement), in order to maximise innovation, the aim should be to ensure that the service provider operates a rigorous risk assessment process such that lighting is replaced as it starts to deteriorate. There is a range of proprietary risk assessment systems that could be used for these purposes.
- 334 Where an item of Apparatus is categorised into a higher risk category, it is intended that this should then form part of the service provider’s lifecycle investment programme and should be subject to a range of financial and contractual incentives. The annual programme should be subject to the review procedure and evaluated by the local authority in the context of the service provider’s financial model and audit of the risk assessment process.
- 335 Through the payment mechanism, financial deductions should escalate in the event of the service provider falling significantly behind the programme. The escalation of deductions should be set at a level such that the service provider is incentivised to recommence and speed up the programme once it has fallen behind. The use of this mechanism should be sensitive to avoid the risk of ‘hair trigger’ deductions. The level of deduction applied should match, or marginally exceed the net annual saving achieved by not complying, to ensure the service provider is fully incentivised to complete the works. The level of deduction applied will therefore need to be set on a case-by-case basis in accordance with a service provider’s financial model.
- 336 In addition, the local authority should consider the following mechanisms to provide full protection throughout the period of the Contract:
 - The use of a service or default termination points regime to provide the local authority with the ability to terminate the Contract on the basis of service provider default once the works have fallen significantly (and persistently) behind programme.
 - Consideration of a Performance Bond to cover any possible shortfall if the service provider becomes insolvent whilst behind the works programmes (see also the guidance on this issue in the *Standardisation of PFI Contracts*).
 - The use of a Retention Fund (as part of the hand-back arrangements).
- 337 The local authority and its advisors should ensure, through careful review, evaluation, and where appropriate negotiation, that the following issues are addressed:
 - The integrity of the service provider’s technical design solution and its ability to meet the performance obligations as set out in the Output Specification.
 - The banking agreements to ensure that the service provider is motivated by the terms of the funding agreements to carry out the works.
 - The contractual default termination provisions in accordance with the bidder’s funding arrangements (especially the division between senior debt and equity) to ensure that, taken together with the investment programme deductions (PS1 in the model Output Specification), the local authority is never exposed to a position where it has paid more in unitary payments to the service provider than it has received in value.
 - The potential effects of re-financing on the proposed arrangements.
 - The cost reductions/improved risk management arrangements arising to the benefit of the service provider.

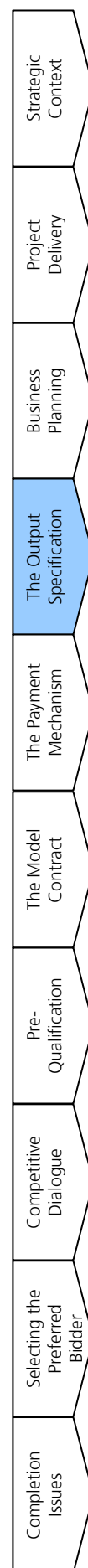


ANNEX A – SCHEDULE OF AUTHORITY INPUTS

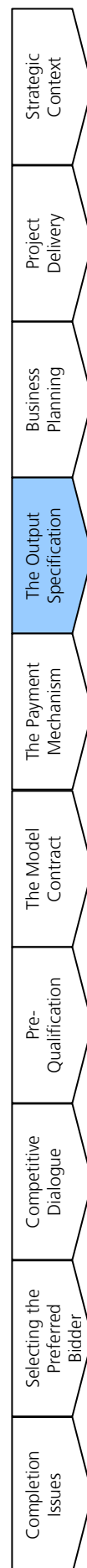
Section	Description	Authority Input
Definitions		
Codes of Practice	Definition	The authority should review the codes of practice listed in Appendix M (Codes of Practice) and make amendments to suit the project specific needs of the authority.
Designated Areas	Definition	The authority should populate Appendix J (Designated Areas)
Festive Lighting	Definition	The authority should populate Appendix O (Festive Lighting Details)
Flood Lighting of Monuments and Buildings	Definition	The authority should populate Appendix R (Flood Lighting of Monuments and Buildings Lighting Details)
[Independent Certifier's Checklist	Definition	The authority should prepare a check list as a template and insert the detail in Appendix P (Independent Certifiers Checklist)
Lighting Up Periods	Definition	The authority should insert lighting up details within in Appendix T (Lighting Up Periods)
Project Specific Design Parameters	Definition	The authority will need to develop "Project Specific Design Parameters" for the project and insert the details within Appendix D (Project Specific Design Parameters).
Specific Lighting Design Standards	Definition	The authority will need to develop "Specific Lighting Design Standards" for the project and insert the details within Appendix C (Specific Lighting Design Standards).
System Boundary	Definition	The authority should insert drawings detailing the system boundary in Appendix L (System Boundary Map)
The Service		
"paragraph 2.1"	Project Aims and Objectives	The authority should insert its project specific "significant benefits" within this section.
"paragraph 2.2"	Project Aims and Objectives	The authority should insert its project specific "strategic aims" within this section.
"paragraph 3"	Scope of the Project	The authority should insert its own project specific scope which should include what is included and excluded from the project.
"paragraph 3.5"	Reference to the Inventory	The Authority should extend this section to include a description of the inventory content i.e., Deemed to Comply details, Age profile, etc.
PS1 - Investment Programmes		
"paragraph 4.4"	Unlit Streets / Roads, Footpaths and Other Areas	If the authority has developed the business case for the project to include additional lighting within selected unlit areas then the authority should provide details within Appendix A (Unlit Back Streets, Roads, Footpaths and Other Areas).
"paragraph 4.5"	Project Specific Apparatus Upgrades and Modifications	If the authority has developed the business case for the project to include project specific apparatus upgrades and Modifications within selected areas then the authority should provide details within Appendix B (Project Specific Apparatus Upgrades and Modifications).



"Paragraph 4.8"	Design	
"Paragraph 4.8"	Design	
"Paragraph 4.9"	Installation	The authority will need to develop a policy with regard to Private Cable Network and insert the details within Appendix E (Private Cable Network Requirements)
PS2 - Planned Maintenance, Inspection and Testing		
"paragraph 5.6"	Planned Maintenance, Lighting Performance Maintenance	The authority should insert details of any trees under preservation orders within Appendix F (Tree Preservation Orders).
"paragraph 5.7"	Planned Maintenance, Bulk Lamp Change and Clean Maintenance	The authority should insert requirements with respect to the bulk change and clean frequencies applicable to Deemed to Comply apparatus in Appendix G (Deemed to Comply Apparatus, Bulk Change and Clean Frequency).
"paragraph 5.14, (a),(i)"	Performance Targets	The authority should insert an appropriate % within the following sentence: <i>"PS2 Performance Target A: [xxx per cent (xxx%)] or more Lighting Points shall be In Light during the Lighting Up Periods;"</i>
PS3 - Operational Responsiveness and Reactive Maintenance		
"paragraph 6.15, Table 3"	Performance Targets	The Authority should review the content within table 3 and modify the descriptors and timescales, if required, to suit the project specific requirements.
PS4 - Contract Management and Customer Interface		
"paragraph 7.6"	Management Information System (Data Sets)	The authority should insert project specific data set requirements into Appendix H (Apparatus Data Sets).
"paragraph 7.13, Table 4"	Performance Targets	The Authority should review the content within table 4 and modify the descriptors and timescales, if required, to suit the project specific requirements.
PS5 - Strategic Assistance and Reporting		
"paragraph 8.4"	Audit and Performance Indicators	The authority should insert project specific performance indicators into Appendix I (Performance Indicators).
"paragraph 8.4,(b)"	Monthly Service Report	The authority should insert Monthly Service Report Templates in Appendix Q (Service Report Content).
"paragraph 8.4,(a)"	Annual Service Report	The authority should insert Annual Service Report Templates in Appendix Q (Service Report Content).
PS6 - Working Practices		
"paragraph 9.3"	NRSWA	The NRSWA requirements specific to the project should be reviewed and amended text should be inserted to suit. When amending the text reference should be made to the Performance Requirements within this PS6.
"paragraph 9.15"	Festive Lighting	The festive lighting requirements specific to the project should be reviewed and amended text should be inserted to suit. When amending the text reference should be made to the Performance Requirements within this



		PS6.
PS7 - Reporting to the Authority		
General comment		This PS should be used without the need for any project specific changes.
PS8 - Post Core Investment Programme Period (optional see footnote within the model Output Specification)		
General comment		If the authority has developed a project that has Temporary Deemed to Comply Apparatus within the scope then this PS should be included with appropriate cross-references in the PS's.



**STREET LIGHTING
PROCUREMENT PACK
PART FIVE
THE PAYMENT MECHANISM**

Strategic
Context

Project
Delivery

Business
Planning

The Output
Specification

The Payment
Mechanism

The Model
Contract

Pre-
Qualification

Competitive
Dialogue

Selecting the
Preferred
Bidder

Completion
Issues

Contents – Part Five – The Payment Mechanism

Section 1
Objectives of the Payment Mechanism

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Section 2
Key Features of the Payment Mechanism

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Section 3
Developing the Payment Mechanism

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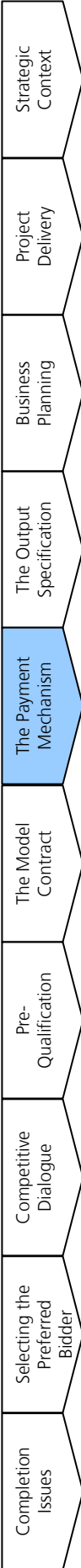
Section 4
Key Points for a Street Lighting Scheme

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Also relevant to this Part Five of the guidance is:

- **Model 2 – Payment Mechanism Paper (for the Invitation to Submit Detailed Solutions)**
- **Model 3 – Payment Mechanism Schedule (for the Model Contract)**

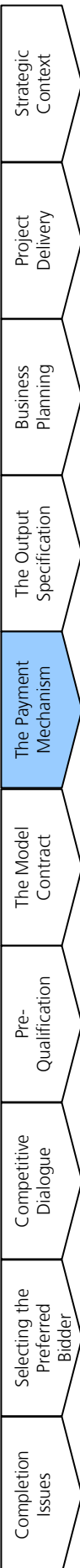
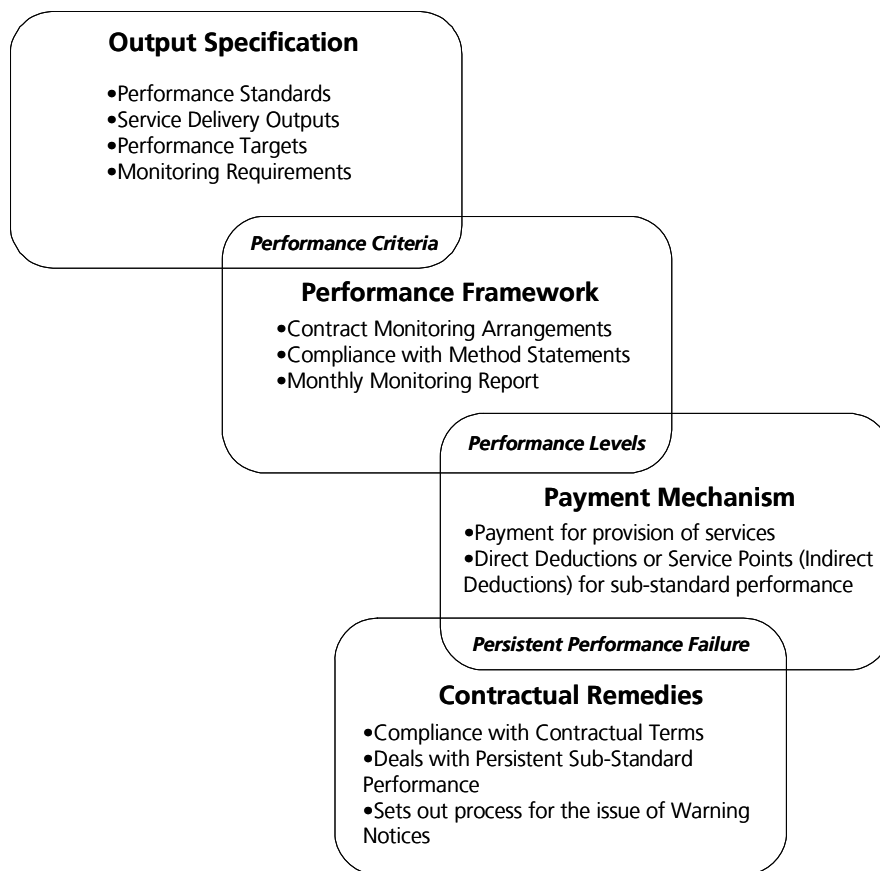
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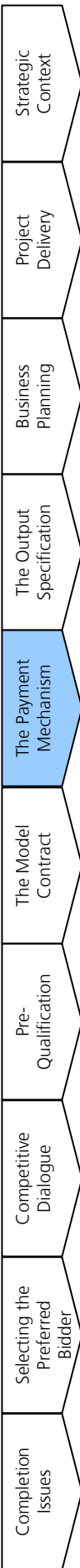
Section 1 Objectives of the Payment Mechanism

- 338 The Payment Mechanism is fundamental to the PFI Contract, as it puts into financial effect the allocation of risk and responsibility between the local authority and the service provider. The payment mechanism should be objective, transparent, and easy to operate. It ensures that the local authority's objectives for the project are being delivered, and it should be linked to the outcomes and outputs for the project set out in the Output Specification. The Payment Mechanism should include appropriate incentives for the service provider to deliver the service in a manner that gives Best Value, and promotes partnership working.
- 339 The Payment Mechanism for a project will need to be tailored and structured to reflect the particular needs of the local authority and the relevant stakeholders, and the nature of the deal. For those involved in developing the Payment Mechanism, it is vitally important to see the 'fit' between the service requirements set out in the Output Specification, the Payment Mechanism, and Contract monitoring regime, and to understand the different roles that the local authority and individual stakeholders will play in them. The relationship and interoperability between the Output Specification and the Payment Mechanism, which should be developed in conjunction, is demonstrated in Figure 5.1.1.

Figure 5.1.1 - How the Payment Mechanism links with performance



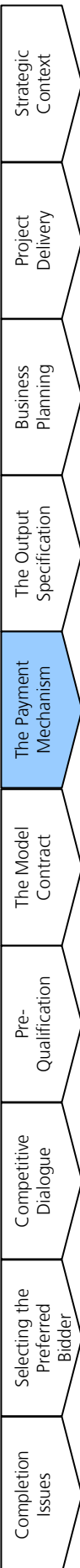
- 340 The general objectives of the Payment Mechanism should be to:
- Provide the means by which the service provider can secure the full unitary charge (i.e. the agreed payment for the service agreed in the Contract) for delivering the service within a framework of realistic, challenging, but achievable performance standards
 - Provide an incentive to the service provider to meet the performance standards set out in the Output Specification by placing payment of the unitary charge at risk if performance falls below the agreed standard
 - Match payments to the outcomes and outputs that the local authority wishes to see delivered from the service project
 - Provide an incentive for the service provider to rectify problems by escalating penalties for worsening performance, or failure to act promptly on items failing to meet the agreed performance standards and performance targets
 - Provide an incentive for the service provider to innovate and secure efficiency gains and deliver Best Value throughout the period of the Contract.
- 341 A specific objective of the Payment Mechanism for a project may be to seek support from the service provider to enable the local authority to demonstrate that the project is meeting, and continues to meet, the service objectives developed for the scheme as part of the initial appraisal.
- 342 Since the essence of a PFI arrangement is the procurement of a service, sub-standard performance of that service by the service provider should result in reduced payment by the local authority or, in certain circumstances, no payment.
- 343 The Payment Mechanism will determine whether and how much the service provider is paid at the end of every payment period designated in the Contract. In determining the appropriate parameters to be included in the Payment Mechanism, regard will need to be given to the measurement and prediction of those parameters, and the ability of the service provider to influence and control the delivery of the service within them. The challenge is often deciding which of a number of different components should be used in the Payment Mechanism, whether alone or in conjunction with each other.



Section 2

Key Features of the Payment Mechanism

- 344 The key features of the Payment Mechanism can be summarised as follows:
- The local authority should make no payments to the service provider until the service is available
 - Payment should be made only to the extent that the service is meeting the performance standards set out in the Output Specification and Contract
 - The Payment Mechanism should provide for deductions to be made for sub-standard performance so that the service provider is worse off than if the required service had been delivered. Deductions should reflect the severity of failure, i.e. 'no service' should lead to 'no payment', but a minor failure should only cause at most a minor deduction, except in the case of prolonged and/or persistent failure, where a ratchet mechanism should be used to increase the level of deduction.
- 345 Since the basis of the PFI is the procurement of a service, the unitary charge should not be made up of sub-elements, which relate to delivery of any input – for example, completion of stages of works, cost of materials or labour. Similarly, the Payment Mechanism should never contain a fixed element that the service provider always receives, irrespective of performance, such as a fixed payment that covers the service provider's debt service obligations.
- 346 The Payment Mechanism should flow directly from the service requirements, as defined in the Output Specification. Payment of the full unitary charge should only commence when the local authority accepts that the service is fully available to the required standard. However, it will be important to consider any transitional arrangements such as during a 'settling-in period' or during the build or investment period when new assets or infrastructure are being introduced alongside existing services.
- 347 When drawing up the Output Specification and the associated outcomes, outputs, performance standards and Payment Mechanism, important factors that will have been taken into account that have an impact on the payment mechanism are:
- Service delivery itself must be capable of measurement
 - Both quantity and quality of service are important, and both need to be capable of measurement
 - Performance standards must be measurable, recordable, and reflect commercial reality.
- 348 There is also an important relationship between the Payment Mechanism and risk. The structure of the Payment Mechanism drives the allocation of risk between the local authority and the service provider, and as such must deliver value for money.



Section 3 Developing the Payment Mechanism

- 349 It is important that appropriate consideration is given to the Payment Mechanism at an early stage in the development of a PFI project, and that payment parameters are developed that reflect commercial reality. As well as being an incentive for the service provider to deliver the outcomes and outputs that the local authority considers are important, the Payment Mechanism must also be fair, and support the long-term partnership.
- 350 A view on the components of the Payment Mechanism should be developed as part of the business planning process, ideally supported by soft market sounding or deal testing of the initial proposals for the Payment Mechanism. At an early stage the local authority will also need to assess the likelihood of certain events arising, and from that determine a range of performance targets that are acceptable to both the local authority and potential bidders.
- 351 The approach developed as part of the business planning work will need to be fine-tuned during the procurement process. An approach now being used by many local authorities is to develop a 'Payment Mechanism Paper' for inclusion in the 'Instructions and Guidance to Bidders' section of the ISDS that sets out the local authority's proposals for the short-listed bidders in a clear and succinct way. The Payment Mechanism Paper should support the detailed proposals in the Output Specification and the Payment Mechanism Schedule in the Model Contract issued as part of the ISDS. A model Payment Mechanism Paper and model drafting for the Payment Mechanism schedule of the Contract are included in this Procurement Pack: Model 2 is a Payment Mechanism Paper and Model 3 is a Payment Mechanism Schedule. Local authorities are encouraged to consider the models in this Procurement Pack for developing the payment mechanism, and adapt these to reflect the aims and objectives of the local authority and other stakeholders in the project.
- 352 A basic principle in developing the Payment Mechanism is to focus on a unitary charge for delivery of the whole service, not broken down into separate elements for infrastructure, operations and maintenance. Payments for availability that are completely separable from payments for the ongoing services do not sit comfortably with the aim of getting best value for money, as the inter-relationship between the availability of the core function and the provision of associated services is lost. Separating the components in this way is also likely to make it more difficult for the transaction to satisfy the DCLG and PRG PFI criteria, specifically for the transaction to be off balance sheet in accordance with FRS5.
- 353 Many local authority PFI and PPP projects have been developed around a series of performance standards that effectively merge the availability and performance components. These performance standards have typically been developed alongside the Output Specification for the project, to ensure a clear linkage between the Output Specification, performance standards and the Payment Mechanism.
- 354 An overview of the approach used to develop the Payment Mechanism for a service project is shown in Figure 5.3.1.

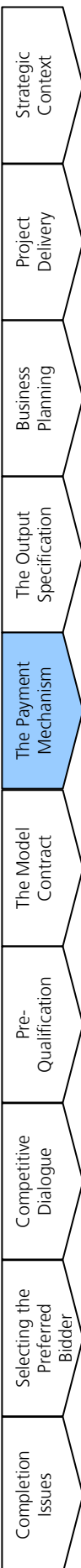
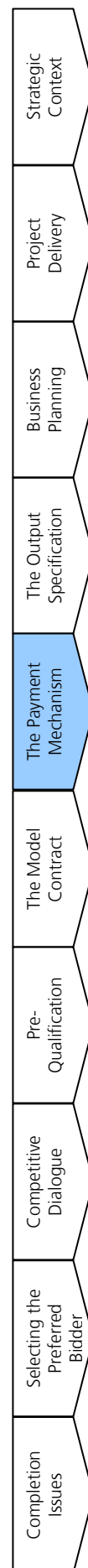
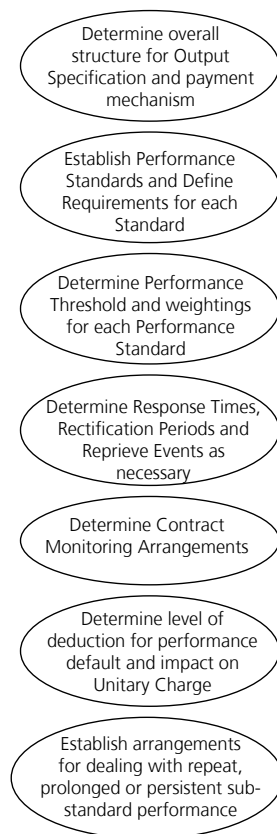


Figure 5.3.1– Overview of the Payment Mechanism for a [Service Area] Project



Performance Standards

355 Payment of the maximum possible level of the unitary charge should be conditional upon the satisfactory performance of the service provider. The Output Specification and Payment Mechanism should, therefore, set out:

- The level or target of performance required
- The means by which the local authority is able to monitor the service provider’s performance against the required target
- The consequences for the service provider of a failure to meet the required level or target.

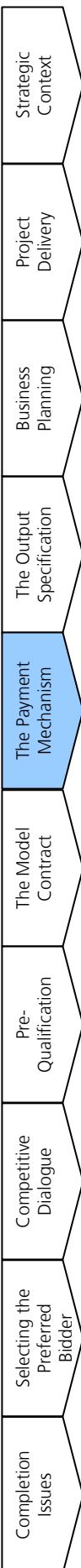
Setting the Performance Targets

356 In setting the performance targets for the Output Specification and Payment Mechanism, the local authority should focus on the standard of service it requires (ideally determined from a strategic service review or Best Value Review) and not, for example, on what it is familiar with. If the local authority or a third party is already providing the same type of service or part of the service, this may provide a benchmark from which the local authority is able to develop appropriate performance targets. However, it is important that the local authority is realistic with regard to the affordability of its proposals and how they relate to the quality of services currently being provided as part of the service.

- 357 In developing the performance targets, local authorities could, alternatively, refer to the average performance level of a comparator group made up of other providers of the same or similar service to the local authority. The difficulty here is that if there were a reduction in quality of service elsewhere, then the service provider would benefit in that it would (even if perfectly able to perform, unaffected by the reason for a wider deterioration) have an opportunity to perform the service at a lower level. Further, the Best Value regime requires local authorities to make arrangements to demonstrate continuous improvement in their services, and they will need to determine how this should be done in the context of the performance regime linked to the performance levels of a comparator group. However, benchmarking against a comparator group may be particularly useful where the service to be delivered has not been measured before in the manner required by the monitoring regime in the Contract. An untested performance standard may by itself result in performance deductions being too high or too low, so a mechanism for setting the level by comparing similar services might avoid this problem.
- 358 In setting the performance targets, the local authority will need to define what is meant by the performance target. The definition will typically specify certain conditions that must be met if the service is to be treated as performing satisfactorily. As payment depends on the definition being met, the service provider and financiers will naturally be concerned that the definition consists of objective, measurable and reasonable criteria, so that it is clear to both parties whether or not those criteria have been satisfied. They will seek to establish that the unitary charge will not, save in circumstances which they have satisfied themselves are unlikely to occur, drop below a level that allows senior debt to be serviced and an equity return to be paid.
- 359 In considering what a reasonable performance level is, the local authority should decide what the optimum 100% performance standard would be and whether it is achievable and essential (taking into account the nature of the service), and to set the required standard in the Contract at this level. For example, in a number of cases, the optimum 100% standard will always be required and should always be achievable. In other cases, the local authority may recognise that the optimum 100% standard is not, in practice, always essential or offering Best Value. In determining the relevant performance standard, a balance will need to be struck between value for money and standards of service required.
- 360 In general terms, performance should be defined in as simple a way as possible. Complex definitions that require excessive monitoring should be avoided, although definitions may have to be very specific.

Prioritising Performance Standards

- 361 It may be appropriate for the local authority and other stakeholders to give a weighting to different aspects of the service or performance standards within the project according to their importance to overall service delivery. Failure to perform an aspect of the service results in a payment deduction that reflects the relevant weighting of that aspect, and subsequent days of sub-standard performance of the same aspect lead to progressively higher deductions.
- 362 The effect of weighting can also be achieved through - or, exceptionally in conjunction with - other means, for example by allowing shorter rectification periods for key aspects before the service provider suffers deductions.

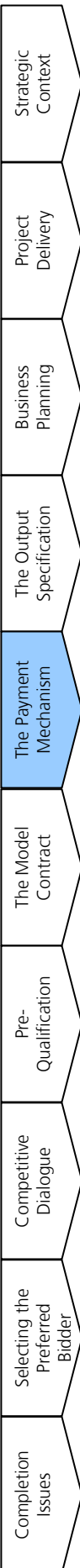


Rectification Periods

- 363 Any number of specified events could give rise to the sub-standard performance of a particular aspect of the service. For certain performance standards the service provider may be given a rectification period in which to resolve the problem, dependent on the event. If the problem is left unresolved at the end of the rectification period, that particular aspect of the service will be deemed to not meet the performance standard, and payment should be reduced accordingly.
- 364 How long the rectification period should be (for example, one hour or twelve hours) will depend on the criticality of the aspect of the service. The local authority should consider carefully any requirement for rectification periods, taking into account tolerances already built into the performance targets, and considering those events which lead to immediate sub-standard performance and those which do not, but which provide an opportunity for rectification prior to failing to meet the performance standards.
- 365 For those performance standards that include a rectification period, the local authority will need to identify the potential events and allocate to each a rectification period or priority weighting.
- 366 Where an aspect of the service is not meeting the required performance standards, both parties should use all reasonable endeavours to minimise the inconvenience caused to the users of the service.
- 367 If the service provider rectifies the failure within the relevant rectification period, the performance target should be deemed to have been met and no deductions should be made. If the service provider fails to rectify the failure within the relevant rectification period, deductions should be made from the unitary charge.
- 368 In certain instances a fault may take time to permanently rectify. If the service provider has actioned an effective temporary repair and placed an order within the rectification period with a date for permanently rectifying the fault, no deduction should be made. However, if the fault is not permanently rectified by the agreed date, deductions should be made from this date.

When does the Service Commence?

- 369 Many local authority PFI and PPP projects will involve taking over an existing service, coupled with a phased implementation of new or improved assets or infrastructure. Local authorities may wish to include a specific performance standard related to the investment requirements as a means of enabling a deduction against the full unitary charge until the new service is being delivered in accordance with the Output Specification. Where this approach is to be adopted, the level of the deduction during the build or investment period will need to be sufficient to incentivise timely completion of the project facilities, and to ensure that the local authority is not paying for services not being delivered to the agreed performance standards.
- 370 An alternative to this approach would be for the local authority to make no payment in relation to the services received during the transitional period. This would maximise the incentive on the service provider to bring the facilities up to the service commencement level as quickly as possible, but the local authority may lose some influence over the standard of service during the transitional period. As the two approaches will lead to different funding requirements and cash flows for the service provider, and therefore may have a significant impact on price, the local authority should assess which of these approaches to adopt, depending on the value for money they provide. The issue of 'existing services' is discussed further in Part Six of this Procurement Pack.



371 The Contract must specify what happens if the Service Provider is able to provide the full service earlier than the expected completion of the build or investment phase. The local authority should not be obliged to make any payment of the unitary charge before the expected date (as incorporated in the Contract), unless it has agreed in the Contract to accept earlier commencement and that early commencement is practical and agreed (and affordable).

When does Sub-Standard Performance Commence?

372 The Contract must specify precisely when sub-standard performance starts so that both parties can measure any permitted rectification and calculate any payment adjustment that will apply. Both parties should be notified as soon as practicable when sub-standard performance is discovered. Possible triggers that should be considered are:

- When any automated monitoring system identifies a performance failure
- When service provider monitoring indicates that the performance criteria are not being met
- When the service provider, such as through a Customer Care System or ‘Call Centre’ provided by the service provider, receives a notice from the local authority or member of the public, specifying that there is a performance failure.

373 If the local authority detects sub-standard performance but is unable to notify the service provider because, for example, there is a failure in access to the Customer Care Centre as a result of service provider default, then sub-standard performance commences from the time when the failure is detected. If, however, the local authority fails to notify the service provider until later because of other duties, then any applicable rectification period should not commence until the service provider has been notified.

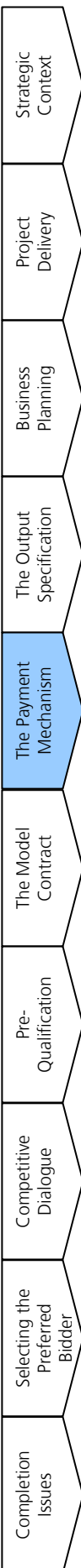
374 Deductions by the local authority for sub-standard performance should be excused if it is caused by local authority step-in, for example to deal with a serious risk to the health and safety of persons or property (unless caused by the service provider).

Restoration of Performance

375 The Contract must include a mechanism for assessing when performance has been restored. There should be an agreed procedure for both parties to be notified, particularly so that the local authority can, where necessary, confirm restoration.

Planned Maintenance

376 Regular maintenance will be necessary if the service provider is to meet the performance standards set out in the Output Specification over the life of the Contract. The Output Specification should specify the periods when the service is to be delivered to the agreed performance standards. Any programme of planned maintenance should be agreed as part of the competitive dialogue process so that it is clear which aspects of the service will be affected, and when the maintenance will take place.

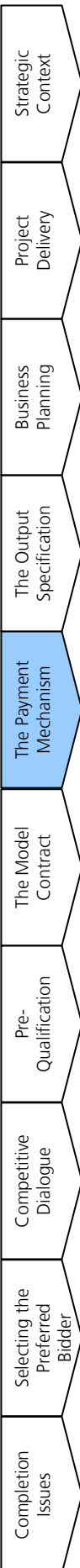


Contract Monitoring

- 377 There must be a mechanism under the Contract that enables the local authority to easily and cost-effectively monitor the service provider's performance against the performance standards agreed in the Contract, so that the Payment Mechanism can operate effectively. Local authorities have generally found the accumulated knowledge of managing other contracts has been helpful in developing the monitoring arrangements for their PFI projects.
- 378 The monitoring requirements should be set out in the Model Contract, and a full methodology sought from bidders as part of their submission of solutions (the model documentation included in this Procurement Pack assumes that contractual Method Statements will be sought for monitoring key aspects of performance). The methodology should include a substantial element of self-monitoring by the service provider, subject to periodic local authority compliance audits and inspection. Additional local authority monitoring will also take place on an exceptional basis, for example local authority staff identifying and reporting performance failures. The monitoring arrangements will be critical to the management of the Contract, and to the Payment Mechanism, and should be specifically tailored to the particular requirements of the local authority.
- 379 Monitoring involves the collection and evaluation of data that should be objective, relevant and quantifiable, and agreed with the service provider. There should be a clear connection between the data collected and the financial deductions for sub-standard performance. In certain circumstances it may also be possible to encompass the correct monitoring and provision of accurate reports as a specific performance standard within the Output Specification and Payment Mechanism.
- 380 In some instances it may not be viable for a service provider to monitor the performance of every aspect of the service in every payment period (for example because it is not cost-effective to introduce the relevant technology). Where this is the case, arrangements will need to be put into place to determine how sample inspections might be used in the monitoring regime, and how the results of the sampling in any one period will be extrapolated to reflect the likely position on the whole service.

Commencement of Contract Monitoring

- 381 The Contract must specify whether the performance regime applies in full from the service commencement date, taking account of any transitional, or build or investment period. It is recognised that problems may be inevitable in the settling-in period, and the service provider might be afforded a degree of flexibility. It can often take time for a service provider to settle into a Contract and perform at the levels of service specified. The performance of a service provider in the initial operational period of a Contract, and how the local authority responds, can have a major bearing on the long-term success of the partnership.
- 382 Local authorities need to consider whether they will allow a settling-in period, how long this period should be and how they will deal with any service problems during this time. For example, the local authority may allow the service provider a three-month settling-in period. During this time, monitoring takes place, but any financial deductions imposed on the service provider for sub-standard performance are set at a lower level than is the case once operations are fully established. In such instances, this does not affect the local authority's rights to terminate for service provider default. Alternatively, the local authority could make adjustments under the Payment Mechanism at the normal contractual rate so that the local authority only pays for the services that it receives, but to apply a more lenient mechanism in counting the payment deductions or service points which trigger the right to terminate for service provider default.

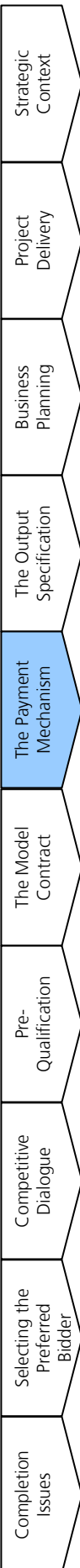


Who Does the Monitoring?

- 383 A key issue that will need to be determined is who will do the Contract monitoring - the local authority, the service provider, a partnership between the two, or a third party. In general, monitoring should occur at three levels:
- Systematic Contract monitoring by the service provider through the use of a quality management system or automated monitoring processes
 - A review by the local authority of the quality management system used by the service provider, with certain planned and random spot checks (with an ability to increase monitoring for repeated failure or poor performance)
 - A system that allows users (for example, members of the public) to report failures if and when they occur.
- 384 Failure to agree the monitoring arrangements will cause difficulties, particularly if disputes arise on the issue of whether a payment is due. Monitoring is ultimately the responsibility of the local authority, but in many cases it requires the information that can only be gathered with the co-operation of the service provider.
- 385 The right approach will always require co-operation between the parties, as benefits will accrue to the service provider as well as the local authority. Where a service provider is providing the information, the local authority should obtain a right of audit and inspection to verify the information. Penalties should be imposed if it is found that the service provider is not following the agreed self-monitoring procedures.
- 386 The local authority must ensure that sufficient resources and people with the right level of experience are available to manage and monitor the Contract. Some local authority projects have arranged for joint training and development of local authority and service provider staff to encourage this partnership working. Local authorities will also need to bear in mind their service strategy, CPA and Best Value obligations, and ensure that the service provider is willing to assist the local authority to meet these wider strategic responsibilities, including assistance with any audit and inspection of the contracted services.

Who pays for the Monitoring?

- 387 Monitoring arrangements impose obligations on the service provider and may cause concern about any exposure to onerous obligations. It is therefore sensible for each party to bear its own costs of monitoring, and this should reassure the service provider that the local authority would not act with too heavy a hand, and avoid any possible conflict of interest.
- 388 The local authority should ensure that the monitoring arrangements are proportional to the consequences of service failure. This will ensure that where it is possible to have a less onerous system, it will be in all parties' interests to do so. Equally, where the consequences of failure are severe, then a rigorous monitoring system should be specified.

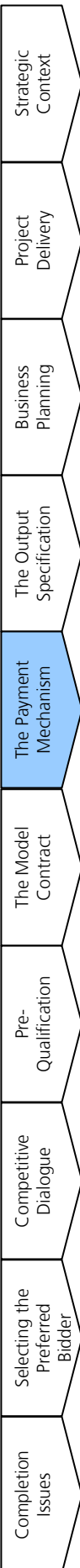


Addressing Qualitative Factors

- 389 Objective performance criteria should always be used as far as practicable, but other methods of measuring performance may be appropriate. For example, there may be qualitative aspects of performance to which it may be difficult to apply the Payment Mechanism objectively but which are nevertheless important to the users of the service, or members of the public. This issue will be particularly important for local authorities given the responsibilities for demonstrating Best Value and user consultation, including as part of the service strategy.
- 390 A possible approach for measuring these qualitative aspects in a service project would be the use of Customer Satisfaction Surveys. Such an approach to performance measurement would need to complement rather than replace objective performance criteria.
- 391 It is difficult to base financial compensation on Customer Satisfaction Surveys because they are based on individuals' perception rather than hard measurable facts, and so the results of an individual survey may be variable. Over time, however, they are a useful way of monitoring performance, and have been used successfully in a number of local authority PFI and PPP projects. The model Output Specification and Payment Mechanism included in this Procurement Pack assume that Customer Satisfaction Surveys will be incorporated as part of the Strategic Assistance and Reporting performance standard with the service provider required to undertake or assist the local authority undertake such surveys.

Reporting the results of Contract Monitoring

- 392 The Contract will need to specify the way in which information regarding the results of monitoring is reported. Wherever possible, monitoring should allow co-ordination of report production in a way that avoids duplication of effort and all parties should consider carefully what is needed.
- 393 The key issues that have to be considered include the following:
- What reports are required by whom and how frequently? Do different people in the local authority, for example the Contract Manager, Service Director, and the Director of Finance, require different reports?
 - Has the local authority specified a requirement for an Annual Service Report to assist it meet the local authority's requirements for reporting against the service strategy, CPA and Best Value obligations, and contribute to the production of the service strategy? What should be covered in the Annual Service Report?
 - Is there to be a standard monitoring form or IT-compatible format to present the results?
 - How soon after a monitoring period is the report to be received?
 - Is external assessment required of any performance monitoring arrangements?
 - How often are partnering and review meetings required between the local authority representative and the service provider representative?

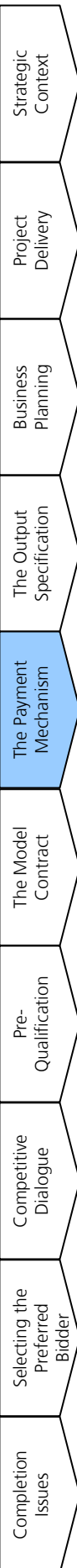


Consequences of Sub-Standard Performance

- 394 The Contract must set out clearly the financial consequences of any failure by the service provider to perform to the performance standards set out in the Output Specification. If the service provider fails to perform to the agreed targets, there can be both direct and indirect incentives to remedy the failure:
- The direct approach involves immediate deductions from the unitary charge, reflecting failure against a performance standard; failure to meet the agreed targets results in a deduction from the unitary charge. The Contract should contain sufficient incentives for the service provider to rectify the fault, but sub-standard performance for a prolonged period could trigger a termination event.
 - The indirect approach involves sub-standard performance being addressed by the award of service or performance points, which will vary according to the severity and regularity of the breach. When the service provider accumulates a certain level of service points, the consequence is a deduction from the unitary charge. Once performance deteriorates below a certain level, or a certain number of service points are accumulated, then a range of other incentives can be imposed, from formal warnings to, in extreme cases, termination for breach of Contract.
- 395 The local authority may use a combination of direct and indirect deductions to address failure. Care should be taken, however, to avoid unintended double counting of deductions in respect of the same failure. If a proportion of the project funding is being met from third-party revenues, care will similarly be needed to ensure that there is no double deduction in respect of performance failures.
- 396 There should be a clear link between the seriousness of the failure and the potential financial impact on the service provider. Local authorities should avoid imposing arbitrary and punitive financial deductions that do not reflect the cost of rectification or are unlikely to offer Best Value.

Ratchet Mechanisms

- 397 It will normally be appropriate to have a ratchet mechanism to encourage the service provider to improve performance if it is consistently below the agreed standard in relation to a particular part of the service, or if a specific failure is not rectified. This can be useful where the financial deductions that accrue are insufficient to provide an appropriate incentive on the service provider to rectify the fault. Too complicated a regime can, however, be difficult to manage, and including onerous measures in the Payment Mechanism can lead to poor value for money. A key advantage of a ratchet mechanism, however, is that poor performance that continues for a significant period will be more difficult for others interested in the Contract (for example, the financiers) to ignore, encouraging early action by the service provider.
- 398 A simple ratchet mechanism will work by increasing the level of deduction for a particular failure in the service that recurs too often within a specified period. For example, if x percentage is awarded for a failure to achieve a particular output then (x+3) percentage may be awarded for each failure over and above a specified maximum number of failures within a pre-defined period. It is of vital importance to tailor the ratchet mechanism to a particular project in a way that delivers Best Value.



399 In establishing a suitable ratchet mechanism, the local authority will have to be aware of the effects a particular system has on the solution offered by a Bidder. A solution that is capital intensive up front, with reduced consequential life cycle costs, will have one optimum approach, whereas one with lower up-front capital costs but with higher life cycle costs will have a different optimum approach (i.e. they impact at different points in the respective financing plans). It is crucial for the local authority to understand what level of commercial 'pain' best will achieve the result desired by the local authority. An over-rigid approach during competitive dialogue will reduce the scope for innovation by the bidders, and reduce the potential for Best Value to be achieved. Care should, therefore, be taken to set the ratchet at a sensible level, and the local authority will need to decide whether to use a straight-line ratchet or an exponential ratchet.

400 It should not be possible for the service provider to 'earn back' performance deductions retrospectively by performing above the standard required in subsequent periods. The required performance standard should be set at a level that is considered reasonable and achievable. If the service provider is capable of performing at a consistently higher level, then the standard set will either be too low (for example, if the higher level does not offer any additional benefit to the local authority) or the service provider may simply be performing very well and delivering a standard of service at a much higher level than the local authority expected. If the higher level of performance is of additional benefit to the local authority, then it may be appropriate for the service provider to receive additional consideration over and above the usual unitary charge (if this is affordable and agreed).

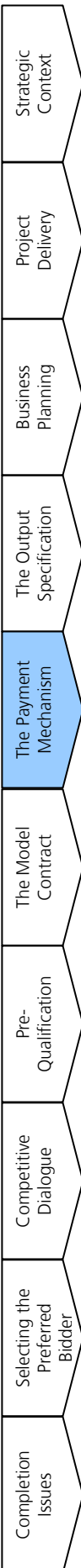
401 Similarly, the service provider should not be able to earn additional payment or additional service points for use to offset against performance failures in any given payment period. The local authority should not be prepared to pay more for improved performance on certain components or elements of the service at the same time that other elements of the service are not being delivered in accordance with the Output Specification and performance standards agreed.

402 However, if a service points mechanism is used it should, after a certain time, disregard points accrued in circumstances where the relevant thresholds for warnings and deductions have not been reached or, if reached, have been dealt with in accordance with the Payment Mechanism and Contract. This is often achieved through the use of a 'rolling points' methodology.

Dealing with Persistent Breach

403 There are various ways of dealing with the persistent occurrence of minor defaults but the recommended approach is to impose service points in respect of all types of minor defaults. This is a particularly effective means of incentivising the service provider when coupled with a right to terminate the Contract if the total number of service points accrued exceeds a certain level.

404 It may not be feasible in every case to agree an all-encompassing service point's regime. This could leave the local authority exposed to a situation in which minor breaches are occurring persistently or being left un-remedied, but as they have no effect on the unitary charge, the local authority will have little ability to influence the service provider to perform. It may in fact happen that it is cheaper for the service provider not to perform, and suffer the deductions. If such circumstances are likely to exist, the local authority should retain a right to terminate the Contract for persistent breach rather than trigger termination following accrual of a certain number of service points. The service provider and its financiers will be anxious to avoid a 'hair trigger' default, and will wish to ensure the mechanics relating to this default are as objective as possible. As payment and performance mechanisms develop and are seen to work well in the sector, there may be less need for such a provision.



405 Where such a process is necessary, the Contract should include a warning procedure through which the service provider is served a formal preliminary notice that a certain type of breach has been persistently occurring during the service period (the service provider should in any case be aware of such breaches already). If such breach continues to occur persistently in, say, 12 months following such notice (allowing a short rectification period), a final notice is served warning the service provider that any further single occurrence of such breach in, say, the following six months, will entitle the local authority to terminate the Contract. This then gives the service provider a final opportunity to remedy. Once a termination notice is served for a persistent breach, the service provider should not be entitled to any further rectification period, although the provisions of the direct agreement will still apply.

Testing the Proposals for the Payment Mechanism

406 The local authority will need to have, at the commencement of the competitive dialogue stage, firm ideas of the arrangements to be used for the Payment Mechanism. In developing the Payment Mechanism Paper and Contract drafting (ideally using the models included in this Procurement Pack), local authorities will need to test the proposals as they are developed, including the use of market sounding or deal testing at the OBC stage, sensitivity modelling, and to assess the bankability of the proposed solution. This testing should be done before the ISDS is issued to bidders.

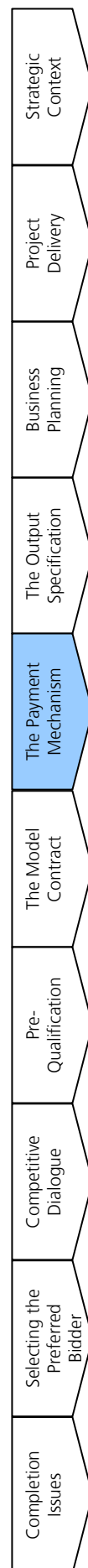
Market Sounding or Deal Testing

407 As noted in Part Three of this Procurement Pack, it is important that some informal market soundings or deal testing be undertaken as part of the business planning process (within the confines of the Procurement Regulations) to determine the appropriateness of the Payment Mechanism proposals. This market sounding or deal testing should ideally be undertaken as part of the wider discussion of the proposed project, covering issues such as scope, objectives, options appraisal, costs, proposed performance standards and targets, and procurement arrangements. As noted in Part Three, local authorities may wish to issue a Prior Information Notice (PIN) to commence a market sounding exercise.

Sensitivity Modelling

408 It will also be necessary to model the effect of combining selected performance parameters in different proportions to see what combinations meet the local authority's objectives, and the relevant PFI criteria requirements such as the off balance sheet test. This can be a complex modelling process that can only feasibly be undertaken for a small number of possible payment parameter combinations. However, it may be possible to reduce the scope of the modelling work by relying on the experience and conclusion of work already carried out on other similar projects.

409 To carry out this modelling work, information will be required on expected future levels of each performance parameter over the life of the Contract; probability analysis is then needed to assess the impact of the future levels. The parameters need to be assessed on as realistic a basis as possible, taking account of all the factors which could influence their future levels. The expected future levels will need to be assessed for year one of operation, and for several future years in the life of the Contract.



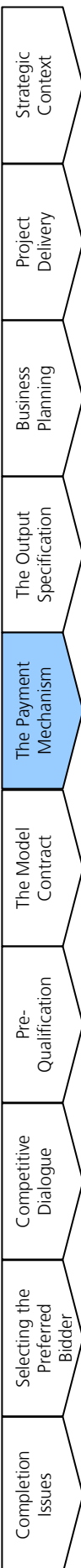
- 410 The more closely defined the shape of the probability curve, the easier it should be to assess the impact of various payment scenarios. However, the assumptions that underpin the probability distribution of the scenarios need to be soundly based and justified by trends, forecasting models, experience elsewhere, and capacity constraints. If the local authority and its financial and technical advisors do not have the information to allow a sensible probability distribution of future levels to be predicted, then the suitability of the parameter for inclusion in the Payment Mechanism will need to be carefully considered.
- 411 Some local authorities have successfully operated a version of their Output Specification and Payment Mechanism on the existing service for a short period to help with this modelling work.
- 412 Local authorities are advised to include worked examples for the proposed Payment Mechanism, ideally for each of the performance standards, in the Payment Mechanism Paper issued to the Bidders as part of the ISDS.

Bankability

- 413 Experience has shown that it is perfectly possible to finance unitary charge systems, provided the Payment Mechanism is objective, reasonable rectification periods are included, and deductions are appropriate. Financiers will typically expect the deductions for sub-standard performance to be accommodated within their financial model runs, which show the sensitivity of the financing to various events. Financiers will inevitably want to assess and minimise the risk of losing the whole unitary charge.

Variations to the Payment Mechanism

- 414 The Contract will set out the unitary charge for the entire Contract term. Due to the uncertainties of inflation rates and certain operating costs over a long-term Contract, it is usually in the interests of both the local authority and service provider to set out provisions for varying the unitary charge in certain specified circumstances. The service provider should always be encouraged to control its costs, but if there are mechanisms for addressing unforeseeable changes in costs, the service provider will not, for example, have to make such a significant provision for this risk in its bid price. Whilst the local authority should ensure it obtains a competitive price by holding a well-run competition, it will take additional comfort if there is some means of ensuring the price it has agreed to pay in future years will not be in excess of future market prices for such services.
- 415 The Contract must achieve the right balance between the provisions for change in law, indexation and any benchmarking and market testing arrangements, as these are inherently interrelated, particularly in relation to the allocation of operating cost risk. For example, if indexation is based on the Retail Prices Index (RPI), the service provider must either bear any cost increases in excess of RPI, or pass these costs to sub-contractors, either directly, or by managing them (for example, through market testing). In addition, a service provider will be more willing to take risk in relation to certain changes in law if they have some protection through the benchmarking or market testing provisions. The local authority should ensure that it considers such inter-relationships in preparing its project documentation.

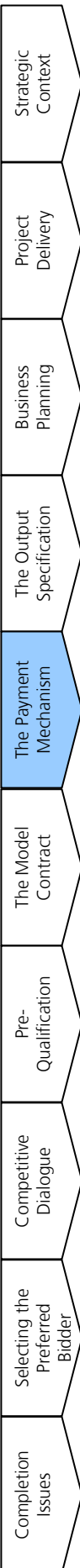


Indexation

- 416 The service provider may be concerned to protect itself against inflation rates increasing over the course of the Contract and so rendering the prices initially set out in the Contract insufficient to meet its operating costs and financing obligations. The Payment Mechanism is likely therefore to include arrangements for indexing the unitary charge agreed at Contract signature. If there is no indexation mechanism, the service provider may have to build a contingency into the price to cover inflation risk. This is unlikely to give the local authority Best Value, as the risk is outside the control of the service provider and, historically, has been difficult to forecast accurately. It is highly unusual for prices to be fixed (i.e. without indexation) throughout the term of a PFI or PPP Contract or, conversely, for the whole unitary charge to be indexed.
- 417 The local authority should focus on the appropriate method of applying indexation to the unitary charge at an early stage in project development (i.e. as part of the business planning work). By the time the Descriptive Document is issued, the Contract should specify the type of index to be applied, and how it will apply (for example, whether it applies to the whole unitary charge or whether it is part of a formula). The local authority should, in deciding what indexation to include in its Descriptive Document, or what percentage of the unitary charge this applies to, give consideration to indices other than RPI. In determining the appropriate approach, the local authority will need to have a clear understanding of the potential funding solutions for the project.
- 418 An alternative way of capturing efficiency gains is to build in price review mechanisms at regular intervals. Significant cost decreases arising from, for example, technological improvements, can then be shared with the local authority. Conversely, the service provider may argue that the local authority should share part of the burden of any significant cost increases outside the service provider's control.
- 419 The local authority should take care with the selection of appropriate indices. Choosing an index that may be short-lived, or is not independently produced, is not a sensible approach, nor does it make sense to have too narrow a focus on a particular industry or sector. This is because, in specific sectors, service providers or their affiliates are themselves responsible to a significant extent for inflationary costs (that is, they can actually affect the index by increasing their price). The choice of index may also have an impact on the transaction satisfying the off balance sheet test under FRS5; basically payments for the property, including capital expenditure and maintenance and lifecycle must be fixed or indexed by a formula linked to general inflation such as RPIX so as not to compromise the FRS5 accounting opinion.
- 420 In determining the approach to indexation, it is important that local authorities properly link these requirements to the unitary charge and not to separable elements of the charge, i.e. the local authority should avoid a direct link between the banding and the cost inputs.

Benchmarking and Market Testing

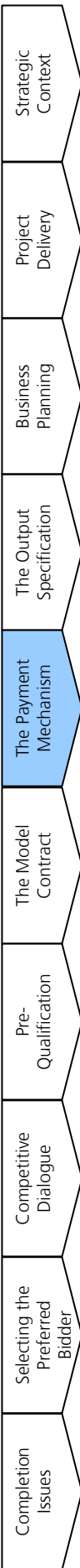
- 421 Although in theory it is sensible to compare costs to ensure that value for money continues, the practice of benchmarking and market testing are often more difficult, and sometimes impossible. This difficulty may be due to the inter-related nature of the services being purchased, and the absence of a ready comparator. Notwithstanding the practical difficulties, benchmarking and/or market testing have been successfully incorporated in a number of local authority PFI Contracts. They should be the responsibility of the service provider, both from a cost and management perspective.



- 422 Generally, only 'soft' services are appropriate for benchmarking and market testing. Soft services are those services that do not involve a significant capital investment in their performance, or affect the value of any capital asset under the Contract. Services such as life-cycle maintenance should not be benchmarked or market tested.
- 423 Given the interoperability of the components of the service, any proposals for market testing will need to be looked at very carefully.
- 424 In developing the approach to benchmarking to be included in the Contract, local authorities will need to take account of their Best Value responsibilities. In particular, the local authority will need to ensure that the service provider is contractually obliged to assist the local authority undertake the Best Value Review in accordance with the appropriate timetable. Perhaps the easiest way to deal with this issue is for the local authority to focus on the Best Value Review of the function, and to incorporate any benchmarking (and potentially market testing) of soft services within the review and benchmarking framework of the Best Value Review. In doing this, local authorities may need to distinguish between Best Value Reviews of the whole function and the benchmarking and market testing of any soft services associated with the PFI Contract.
- 425 Local authorities should be aware that any benchmarking or market testing could result in either an increase or a decrease in the unitary charge, and the Contract will need to include arrangements for dealing with any potential outcomes. A PFI transaction will also need to be off balance sheet in accordance with the requirements of FRS5. The guidance on FRS5 makes it clear that any market testing of services will create a separately identifiable payment stream. Market testing can therefore only apply to purely soft-service related elements of the transaction, as these are not included in the overall assessment of risk associated with owning the asset. Any benchmarking of maintenance and lifecycle costs will have an impact on the FRS5 assessment.

Service Changes

- 426 A change mechanism should be included in the Contract for dealing with changes to the service. Appropriate arrangements will need to be included in the Contract and Payment Mechanism to reflect the impact of any such changes on the Payment Mechanism, where the impact is to be met through the unitary charge.



Section 4 Key Points for a Street Lighting Scheme

Performance Standards

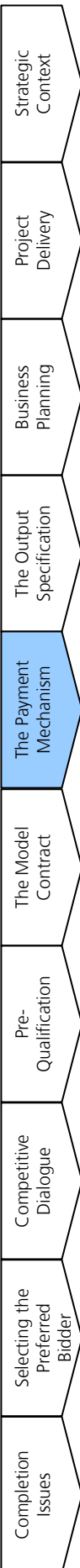
- 427 Payment of the maximum possible level of the unitary charge should be conditional upon the satisfactory performance of the service provider. The Output Specification and payment mechanism should, therefore, set out:
- The level or target of performance required.
 - The means by which the local authority is able to monitor the service provider’s performance against the required target.
 - The consequences for the service provider of a failure to meet the required level or target.
- 428 Street lighting projects have typically focused on the following components in developing the payment mechanism, incorporating seven to eight performance standards.

Lighting Installation

- 429 Since street lighting projects are likely to involve taking over an existing service, an initial investment period will be required during which the service provider will be expected to bring the existing lighting Apparatus up to the Relevant Standards, as set out in the Output Specification. This has generally been referred to as the Core Investment Period, and during this period appropriate deductions will need to be made against the unitary charge to reflect the fact that not all lighting provision is being delivered to the required outputs or standards.
- 430 Bidders should be required to submit, as part of their bid, a programme setting out the number of items of Apparatus that do not meet the Relevant Standards, and propose an Investment Programme for bringing the Apparatus up to the Relevant Standards (i.e. a contractual Method Statement for the Investment Programme). The risk of an item of Apparatus being below the Relevant Standards should ideally pass to the service provider at Contract commencement. Agreement will also need to be reached on items of Apparatus that are deemed to comply with the Relevant Standards set out in the Output Specification.
- 431 During the Core Investment Period, performance of the service provider will be measured against either a reference Investment Programme or against the plan submitted as part of the bid and/or negotiated, usually with arrangements in place to deal with instances where the service provider falls significantly behind the negotiated programme of works.

Lighting Performance – Apparatus in Light

- 432 The local authority will need to set a target for the items of Apparatus to be correctly lit at the times required and the periods when the Apparatus is to be in light. Street lighting projects in operation and procurement have typically used 98% to 99% as the target level, with some projects ramping up from the lower end of this range to the higher end during the Core Investment Period (i.e. there are no deductions against the unitary charge if the target level or more of items are in light). A schedule of deductions against the unitary charge will need to be negotiated that reflects the number of columns not meeting the target level in each payment period.



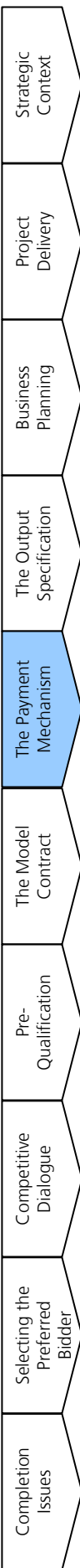
- 433 A local authority may also decide to encompass within the performance standard for Apparatus in light a performance threshold - the expected level of performance that can reasonably be expected. If the level of service drops below the performance threshold in any payment period, a warning notice could be issued. If the performance falls below the threshold the local authority could have the right to terminate the Contract. The model for the payment mechanism included in this Procurement Pack includes provision for a regime of service points, warning notices and ultimately Contract termination.
- 434 The performance level set in the Contract for levels of lighting may need to include provision for dealing with any national standards or targets that may be set for lighting performance as part of the CPA or Best Value regimes.
- 435 For this performance standard, the local authority should expect to rely on self-monitoring, recording and reporting based on scouting, or any technological solution put forward by the bidders. Bidders should be asked to put forward a contractual Method Statement setting out how they intend to undertake the monitoring of lighting performance. The local authority should have the right to audit and inspect compliance of the service provider's monitoring arrangements.

Lighting Performance – Levels of illumination

- 436 As noted in Part 5 of this Procurement Pack, the aim should be to have the new and replacement lighting Apparatus maintained to a design level of illumination, as set out in the Relevant Standards in the Output Specification. The illumination levels of the existing Apparatus are likely to need to be based on agreed maintenance procedures, although existing Apparatus designed to the British or European Standard, and new Apparatus should ideally be linked to a more output-focused measure of illumination.
- 437 Again, monitoring should be based on self-monitoring, recording and reporting, with the local authority having the right to audit and inspect the procedures. Where lighting Apparatus is found to be producing lighting levels lower than the design level (new or updated Apparatus), or has not been maintained in accordance with the negotiated arrangements, a deduction should be made from the unitary charge for each item performing below standard. Payment deductions may need to be based on sample testing and extrapolation.

Lighting Performance – Planned Maintenance

- 438 The aim should be to have all street lighting Apparatus maintained to a structurally, mechanically and electrically sound and safe condition. In developing the Output Specification, the local authority will need to determine appropriate levels of performance for structural, mechanical and electrical safety. A schedule will need to be negotiated setting out the maintenance obligations for each type of Apparatus and for each category a performance target will need to be determined.
- 439 Items of Apparatus will fail to meet the standard if they have not been tested and passed against a safety standard by the date specified in the relevant schedule. Deductions from the unitary charge will be based on the number of items not meeting the required standard.



Operational Responsiveness and Reactive Maintenance

- 440 Rectification periods will also need to be agreed for emergency and non-emergency faults. For each type of Apparatus, there should be a maximum rectification period in which a maintenance or non-emergency repair may be outstanding after detection or notification of the fault. Deductions will need to be agreed for each fault that is not rectified within the agreed period. A multiplier should be used to incentivise responsive rectification of the fault, and self-monitoring, recording and reporting used, with the local authority having the right to audit and inspect the service provider's procedures. Local authority checks could include the right to follow up information from the police and other third parties.

Contract Management and Customer Interface

- 441 The local authority should aim to link part of the unitary charge to the service provider's performance in maintaining records, and generally managing the street lighting service on a day-to-day basis. Standards may be set to cover:
- Management of the Database, Inventory, Management Information System and/or Customer Care System
 - Responding and dealing with telephone, e-mail and written queries and complaints.
 - Attending local authority and service provider review and partnering meetings.
- 442 Bidders should be asked to submit a contractual Method Statement setting out how they intend to manage these aspects of the Contract. A series of performance targets, rectification periods, and deductions for non-performance against the targets will also need to be agreed, with an escalator incorporated in the payment mechanism to deal with persistent sub-standard performance.

Strategic Assistance and Reporting

- 443 In Part 1 of this Procurement Pack, reference was made to the need to consider incorporating in the Output Specification and payment mechanism a specific performance standard for strategic assistance and reporting. Street lighting schemes have incorporated such a standard, and the model documentation included in this Procurement Pack assumes that a proportion of the payment mechanism will be directly linked to the provision of the necessary assistance and reporting requirements to enable the local authority meet its statutory LTP, CPA and Best Value obligations. If there is persistent failure by the service provider to provide the necessary assistance, the model payment mechanism in this Procurement Pack also provides for service points and warning notices to be levied.

Working Practices

- 444 As noted in the model Output Specification included in this Procurement Pack, a performance standard has been developed for 'working practices'. This covers the service provider's performance on issues such as waste management, department, training requirements and complying with statutory obligations.
- 445 Sub standard performance by the service provider against these requirements could be dealt with either through the issue of service points or through a direct deduction regime.



Monitoring and Reporting to the Authority

- 446 The local authority needs to be confident that the service provider is reporting information accurately and that as a result it is calculating the correct payments due from the local authority to the service provider. The model payment mechanism proposes a one off adjustment for any error in a payment period. In addition when an error is corrected the service provider is subject to an additional adjustment of 50% of the value of the reporting failure.

Lifecycle Replacement of Deemed to Comply Columns Post Core Investment Period

- 447 Where substantial lifecycle replacement is proposed to be carried out of deemed to comply columns following the Core Investment Period the local authority may find it appropriate to incentivise the work to be carried out in a timely manner as originally planned by the service provider. The model payment mechanism proposes a deduction to be made based on the number of failures to complete work planned in each year.

Setting the Performance Targets

- 448 In considering what a reasonable performance level is, the local authority should decide what the optimum 100% performance standard would be and whether it is achievable and essential (taking into account the nature of the service), and to set the required standard in the Contract at this level. For example, in a number of cases, the optimum 100% standard will always be required and should always be achievable. In other cases, the local authority may recognise that the optimum 100% standard is not, in practice, always essential or offers Best Value. In determining the relevant performance standard, a balance will need to be struck between value for money and standards of service required. For example, the models in this Procurement Pack include a performance target of 99% for lights on.

Contract Monitoring

- 449 In some instances it may not be viable for a service provider to monitor the performance of every item of Apparatus in every payment period (for example because it is not cost-effective to introduce the relevant technology). Where this is the case, arrangements will need to be put into place to determine how sample inspections might be used in the monitoring regime, and how the results of the sampling in any one period will be extrapolated to reflect the likely position on the whole service.

Consequences of Sub-Standard Performance

- 450 The street lighting projects in operation have tended to focus on the direct approach as the prime methodology, linking sub-standard performance to direct deductions from the unitary charge, with additional arrangements for service points (or default termination points) to deal with persistent breach, and the working practices performance standard.



**STREET LIGHTING
PROCUREMENT PACK
PART SIX
THE MODEL CONTRACT**

Completion Issues	Selecting the Preferred Bidder	Competitive Dialogue	Pre-qualification	The Model Contract	The Payment Mechanism	The Output Specification	Business Planning	Project Delivery	Strategic Context
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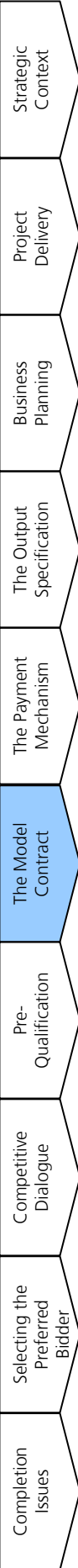
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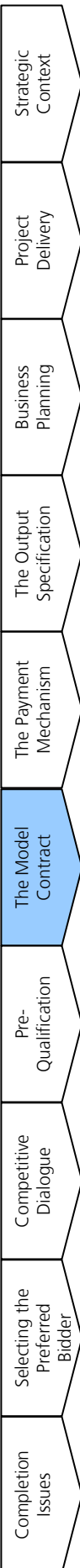
Also relevant to this Part Seven of the guidance is:

- **Model 4 – Model Contract**



Section 1 Developing the Model Contract

- 451 The Model Contract included in this Procurement Pack is intended to enable local authorities to strike a balanced contractual position that is commercially deliverable for a service provider and can provide value for money for the local authority. In providing a common understanding and approach to the issues involved, it should reduce the time and cost of procuring local authority PFI Contracts in the sector. Using the Model Contract as a basis will enable the focus of procurement to be on deal-specific issues, rather than on issues that are generic to PFI/PPP or to local authority PFI projects generally.
- 452 The Model Contract in this Procurement Pack is a sector-specific contract approved by the sponsoring department and HM Treasury. The Model Contract incorporates, as appropriate, the guidance and drafting from the HM Treasury *Standardisation of PFI Contracts* and the 4ps guidance in the local government supplement to *Standardisation of PFI Contracts*. Where derogations from *Standardisation of PFI Contracts* have been determined as necessary for the sector, these have been agreed with and approved by the department and HM Treasury as part of the development of the Model Contract.
- 453 Section 2 of this Part of the Procurement Pack highlights areas within *Standardisation of PFI Contracts* that have particular application, or require particular treatment, and explains how these have been dealt with in the Model Contract (including, where relevant, details and justification for any derogation). The ordering of the issues in Section 2 follows that used in *Standardisation of PFI Contracts*.
- 454 Section 3 of this Part of the Procurement Pack identifies issues that are likely to arise in PFI and PPP projects in the sector that are not addressed in *Standardisation of PFI Contracts*, and explains how these have been dealt with in the Model Contract.



Section 2

Contractual Issues covered in *Standardisation of PFI Contracts*

455 This Section of the Procurement Pack examines the relevance to street lighting PFI projects of contractual issues covered in *Standardisation of PFI Contracts Version 3 - April 2004* as amended by *Further Guidance and Permitted Derogations and Clarifications* published in December 2005 (SoPC). Unless otherwise indicated, the 'Sections' referred to in this Section 2 relate to the relevant Sections of SoPC, and not this Procurement Pack.

Introduction – Section 1

456 Section 1 of the SoPC includes required drafting for a range of general definitions along with a clause dealing with the interpretation of the drafting. The required drafting for the definitions and the interpretation clause has been incorporated into the Model Contract included in this Procurement Pack.

457 In December 2005, clarification of certain definitions relevant to termination payments was included.

Custody Agreement

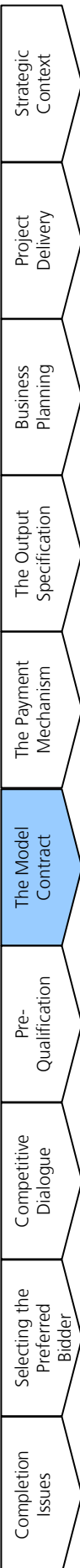
458 It is recommended that the local authority and the service provider jointly appoint an independent company to act as custodian of the financial model. The costs should be paid by the service provider who will include the costs in the Unitary Charge. The Model Contract does not include a standard form of Custody Agreement, but this is a relatively straightforward document which the local authority's legal advisers can draft, and should be included in the Invitation to Submit Detailed Solutions (ISDS) issued to Bidders. The safekeeping of an up to date financial model by an independent third party is important to ensure that the costs of changes are accurately calculated, and the Unitary Charge revised accordingly. Local authorities should not agree to the funders acting as custodian of the financial model

Duration of Contract – Section 2

459 Section 2 of the SoPC sets out the factors to be considered in determining the duration of a Contract and the distinction between the construction phase and the service phase. These issues are relevant to local authority street lighting projects. Local authorities have typically used a Contract period of 25 years for the Standard Bid, principally for consistency with the guidance and evaluation framework published by the DfT (as set out in Part Three of this Procurement Pack), and the Model Contract included in this Procurement Pack assumes that a Contract period of 25 years will be adopted for the Standard Bid.

460 However, street lighting does not involve construction. Therefore, the service starts on the Service Commencement Date (after the mobilisation period) and the service period is 25 years from that date. In certain instances, there is reference to the Core Investment Programme Period which is the equivalent to the construction period in accommodation projects.

461 The Model Instructions and Guidance to bidders included in this Procurement Pack assume that local authorities will be prepared to accept different Contract periods as part of a Variant Bid proposal. SoPC includes required drafting for duration of Contract. The required drafting has been incorporated into the Model Contract included in this Procurement Pack.



Service Commencement – Section 3

462 Sections 3.1, 3.2, 3.3 and 3.5 of SoPC are all relevant to local authority street lighting projects.

Submissions of Designs and Information to the local authority

463 Section 3.4 of SoPC suggests that key aspects of the service provider's Bid should be incorporated into the Contract schedules to ensure that the service provider is bound to deliver the service in accordance with the Method Statements submitted as part of the Bid. The Model documentation included in this Procurement Pack assumes that a number of 'contractual' Method Statements will be sought as part of the Bids and used in the manner suggested in Section 3.4.

464 Section 3.4.1 of SoPC states that the Output Specification will always take priority over the technical solution or methodology of implementation provided by the service provider (as set out in Method Statements). If the local authority wants something to be 'unchangeable' and take precedence, this needs to be noted in the Output Specification.

465 In street lighting projects it is usually not practical for the service provider to have completed at the service commencement date a comprehensive design submission for all streets within the local authority area, because of the scope of the works and in practice services will need to be coordinated with the local authority and its representatives under the New Roads and Street Works Act. The programmes (or Method Statement) will therefore only set out the strategic programme and indicative design proposals for the first annual programme. The Model Contract includes a mechanism for updating these programmes.

Acceptance and Service Commencement

466 Section 3.6 of SoPC relates to acceptance and service commencement. Section 3.6.2 identifies the details that should be set out in the Contract in relation to the commissioning and certification of replaced and refurbished Apparatus. SoPC also specifies that the Contract should set out who is responsible for assessing satisfaction of the tests. The choice of arrangements is a matter for local discretion, but many of the street lighting projects in operation and procurement have adopted the 'independent certifier' approach. If this is not adopted, certification should be done jointly, as SoPC specifies, and the local authority should in no circumstances rely on any advisor appointed by the senior lenders; even under a joint appointment.

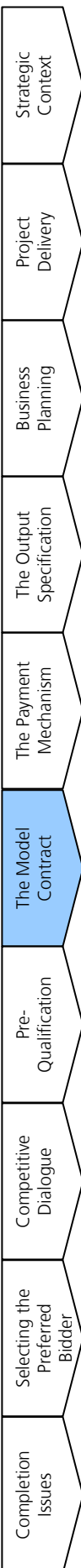
467 The Contract should also set out how minor design variations are to be dealt with. Although the aim will be to install the new Apparatus in accordance with the relevant standards set out in the Output Specification, there may be a small number of instances where the relevant standards cannot be fully complied with, for example because of the location of underground gas mains. A protocol will need to be agreed for determining how such minor design variations should be accepted (such as part of the Review Procedure). Local authorities should take appropriate technical advice to ensure that such instances are kept to an absolute minimum.

Existing Services

468 Section 3.7 refers to the issues that arise if a service provider is taking over existing services, as well as contracting to provide new or additional services. All local authority street-lighting PFI Contracts will involve the provision of existing services and the renewal and/or refurbishment of the existing Apparatus. The service provider will, therefore, be both providing services and installing new Apparatus, and the Output Specification and payment mechanism will need to incorporate provisions to incentivise timely and full completion of the necessary works.



- 469 Section 3.7.2 identifies three options for when the service provider should take over full or partial responsibility for service delivery. The Output Specification and Model Contract included in this Procurement Pack assume that option one is followed. This means that responsibility for the entire street lighting services included in the Contract is taken over by the service provider immediately following the start of the Contract (after financial close), or following a brief mobilisation period. This approach provides a clean start and minimises ambiguity about responsibilities between the local authority and the service provider, and is therefore the recommended approach.
- 470 The other options in section 3.7.2 provide for the street lighting Apparatus to be handed over to the service provider only when it has been brought up to the Output Specification standard (or is 'deemed to comply'). It is considered that adopting such an approach would cause an additional complexity since the responsibilities between financial close and the Apparatus meeting the Relevant Standards set out in the Output Specification would involve more than one service provider delivering the street lighting services. The scope for disputes over responsibility for any problems that may arise suggests that these would not be attractive options, and are therefore not recommended.
- 471 During the renewal/refurbishment period, the Output Specification and payment mechanism will need to include arrangements for ensuring that the service provider is not paid for those elements of the service that do not meet the requirements set out in the Output Specification.
- 472 Street lighting projects have dealt with this through the use of a specific performance standard linked to the 'installation' of Apparatus. This performance standard is referred to as Performance Standard 1 in Parts 5 and 6 of this Procurement Pack, with the model Output Specification included in Part 5 setting out the Relevant Standards for the street lighting Apparatus. Performance Standard 1 includes the concept of a 'Core Investment Period' (typically five years) during which the service provider is required to bring the street lighting Apparatus up to the Relevant Standards.
- 473 Until the street lighting Apparatus is 'certified' as meeting the Relevant Standards set out in the performance standard, a deduction is made from the Unitary Charge to reflect the fact that the service is not meeting all the requirements set out in the Output Specification. In effect, this means that 'full service commencement' is determined at the point that the Core Investment Programme is completed.
- 474 As the service provider will be providing services throughout the Core Investment Period (such as the provision of maintenance and (in some instances) procurement of energy), there will need to be in place payment arrangements to reflect the service received. In street lighting projects this has been dealt with through the use of specific performance standards for other components of the service – Performance Standards 2 to 7 in Parts 5 and 6 of this Procurement Pack.
- 475 An alternative to this approach would be for the local authority to make no payment in relation to the services received during the Core Investment Period. This would maximise the incentive on the service provider to bring the street lighting Apparatus up to the Relevant Standards set out in the Output Specification as quickly as possible, but the local authority may lose some influence over the standard of service during the Core Investment Period. Furthermore, this approach will lead to different funding requirements and cash flows for the service provider and it may well have a significant impact on price. Given the fact that the renewal/refurbishment of the street lighting Apparatus will be undertaken over a relatively lengthy period of time (typically five years) such an approach is not recommended.



476 The local authority should identify in the Instructions and Guidance to bidders the structure that it believes will offer Best Value within the parameters of project affordability, bankability and a reasonable and realistic approach to risk allocation. The model documentation in this Procurement Pack assumes that local authorities will also wish to invite bidders to offer alternative approaches (such as a shorter core investment period) if improved value for money can be shown.

Protections against late service commencement – Section 4

477 Section 4 of SoPC is relevant to local authority street lighting PFI Contracts. Renewal and refurbishment works to the street lighting Apparatus will be completed over a period of years (the Model Contract in this Procurement Pack assumes five years for the 'Standard' Bid for consistency with the DfT appraisal methodology). The local authority is likely to want to protect itself against prolonged delay by the service provider in achieving the full service requirements as set out in the Output Specification (full service commencement). However, in street lighting projects it is unlikely that liquidated damages will be appropriate.

Long Stop Dates

478 Section 4.5 of the SoPC provides guidance on the use of longstop dates. Local authorities procuring street lighting projects have typically incorporated a longstop date after which the Contract may be terminated if the service provider has not completed the Core Investment Programme. The longstop date should be applied to completion of the Core Investment Period.

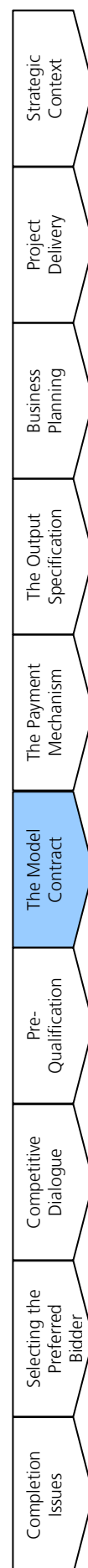
479 As the renewal/refurbishment period is likely to be fairly prolonged, particularly when compared to many other types of PFI project, the local authority should also consider how failure to achieve elements of the Core Investment Programme by strategic milestone dates might be dealt with in the payment mechanism and Contract.

480 The Model Contract included in this Procurement Pack includes drafting for protections against late full service commencement. The Model Contract also includes suggested drafting on milestones within the Core Investment Programme, and for dealing with a failure to complete milestones on time.

481 The Output Specification and Contract will also need to deal with the circumstances where the street lighting Apparatus included in the Contract met the relevant standards at the start of the Contract (deemed to comply), but fails to do so during the investment period, such as a result of failures in the maintenance regime. This would thereby address circumstances where the actions (or failures) of the service provider threaten the local authority's ability to meet its statutory obligations. The model Output Specification included in this Procurement Pack includes appropriate drafting.

Bonus Payments for Early Service Commencement

482 Section 4.6 of the SoPC includes guidance on dealing with early full service commencement. This may be an issue for some local authority street lighting projects, as the service provider may be able to deliver a more accelerated programme of investment than that anticipated at Contract close. Depending on the structure of the payment mechanism, the local authority would need to include arrangements for dealing with any such unforeseen acceleration and the potential implications in terms of affordability.



Supervening Events – Section 5

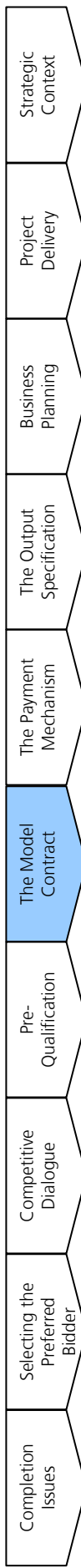
483 Section 5 of the SoPC is relevant to street lighting projects. Three categories of causes of delay in service commencement are identified, for which relief may be appropriate:

- Compensation Events – events which are the local authority’s risk and for which the service provider should be compensated and be given extensions of time
- Relief Events – events that are best managed by the service provider and for which the service provider bears the financial risk, but in respect of which no rights of termination should arise and extension of time may be granted
- Force Majeure Events – a limited set of events that are best managed by the service provider and in respect of which rights of termination can arise.

484 The guidance on each of these events in Section 5 is relevant to street lighting projects. However, there are potentially a number of additional supervening events that may need to be dealt with in a street lighting project, as well as changes / deletion of those listed in SoPC, and figure 6.2.1 outlines the supervening events for a local authority street lighting project over and above those set out in SoPC that have been agreed with DfT and HM Treasury. The drafting in respect of Force Majeure Events and Compensation Events is unchanged from SoPC drafting.

Figure 6.2.1 – Additional Supervening Events for a local authority street lighting project

Relief Events	Excusing Events (relief from the Payment Mechanism)
<p>Replacement of SoPC drafting</p> <p>(b) Failure by any Statutory Undertaker, utility company, local authority (but excluding for the avoidance of doubt the local authority as purchaser) or other like body to carry out works or provide services, but not including the service provider or the Sub-Contractors or any failure by a DNO to carry out the Contestable Works in connection with the Service or any other obligation of the service provider under this Contract.</p> <p>(c) Any accidental loss or damage to [100] or more items of Apparatus in any one event.</p> <p>(d) Any failure or shortage of power, fuel or transport, save to the extent that such failure or shortage constitutes an Excusing Cause within paragraph (f) of that definition.</p> <p>Drafting for additional relief events</p> <p>(g) Failure by a licensed Distribution Network Operator (DNO) for the Area to carry out Non-Contestable Works or services within the meaning of the Electricity Act.</p> <p>(h) Underground cable faults in respect of cables which do not form part of the Apparatus and are not otherwise the responsibility of the service provider under this Contract.</p> <p>(i) The discovery of fossils, antiquities or unexploded ordinance on or about the land on which the Apparatus is (or is to be) erected.</p>	<p>(a) A Necessary Consent to fix Apparatus to a structure is not obtained.</p> <p>(b) Where an Owner requires that Apparatus be removed from a structure permanently.</p> <p>(c) Where the Service Provider requires access to land off the highway which is outside the control of the Local Authority for the performance of the Service.</p> <p>(d) Where there are Relevant Highway Works of which the Local Authority has given notice pursuant to clause 17.3 (Public Highway Works).</p> <p>(e) The carrying out of Highway Works in respect of which the Local Authority did not issue a notice.</p> <p>(f) Any failure of, or disruption to, power occurring to the electricity distribution system belonging to a DNO excluding the low voltage cable which supplies the Apparatus.</p> <p>(g) During the Core Investment Period only, the occurrence of circumstances where the Service Provider cannot Remove CIP Apparatus as a result of works which are being carried out on a Public Highway which works: <ul style="list-style-type: none"> • Require entry in the Street Works Register; and • Have not been entered in the Street Works Register; and • Materially affect the ability of the Service Provider to progress the Core Investment Programme Service. </p>



485 As can be seen from figure 6.2.1, the concept of excusing events has been introduced within the categories of supervening events. The intention of the excusing event concept is to also allow relief from payment mechanism deductions and termination as well as granting extensions of time for the specific category of event. The concept of excusing event should be strictly limited to the events specified in figure 7.3.1.

486 SoPC required drafting for supervening events, and drafting on the issues noted above (including appropriate definitions), has been incorporated into the Model Contract included in this Procurement Pack.

Information Warranties – Section 6

Due Diligence and local authority Warranties

487 Sections 6.2 and 6.3 of SoPC relate to service provider due diligence and local authority warranties. The guidance on these issues is applicable to a street lighting project where the service provider will be heavily dependent, in its assessment of the relevant risk, upon the accuracy of the historical information and data provided by the local authority as part of the procurement process and in response to service providers' due diligence enquiries.

488 In street lighting projects it is not common practice to provide any warranties in relation to the quantity, description, location and condition of the transferring Apparatus. However, in this context local authorities should have regard to the criteria listed in paragraph 6.3.1 of SoPC where the granting of such warranties would help to reduce the service provider's costs. However, in this case the local authority would be liable for compensation arising from the inaccuracy of any information that is warranted, and the Contract should contain an appropriate price variation mechanism.

489 Section 6.3.3 of SoPC includes required drafting for a typical exclusion from Contracts in which warranties are not given by the local authority. The required drafting has been incorporated into the Model Contract included in this Procurement Pack.

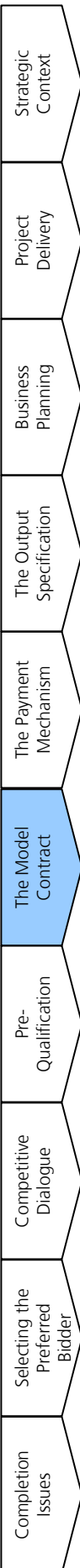
Benefit of Surveys and Reports

490 Section 6.4 of SoPC deals with surveys and reports. The local authority should consider the extent to which the perceived value of latent defect risk can be minimised by the availability of detailed survey information on the existing condition of the Apparatus. Such surveys will be a key consideration in pricing.

491 As part of the business planning process, the local authority will need to have collected data on the total stock to be included in the Contract, and to have made a preliminary assessment of the condition of that stock. The local authority should not provide a warranty in relation to this lighting stock. Whilst this data will have been used to develop the PFI Reference Project and to assess affordability, the information produced is unlikely to be sufficiently comprehensive to enable bidders to make a priced assessment of the impact of latent defects risk.

492 There are a variety of options for obtaining more detailed survey information:

- The local authority can commission more detailed surveys. If this option is followed, the local authority should agree the specification and appointment with the short-listed bidders, and either ensures that the survey can be novated or transferred to the winning bidder, or that an appropriate warranty is available in its favour. The winning bidder should in turn reimburse the local authority for the costs of the survey.



- In order to avoid all of the short-listed bidders duplicating work, an alternative may be for the short-listed bidders to jointly commission, and pay for, surveys to their specification, perhaps with the winning bidder reimbursing the other bidders. This approach will be dependant on the short-listed bidders (and their financiers) being able to agree on the scope and terms of reference for the survey work.
- Each bidder can undertake whatever survey work they feel necessary.

493 Based on the experience from the street lighting projects in operation and procurement, it is likely that the short-listed bidders will opt for the third option noted above. However, local authorities, particularly those with good historical data on the street lighting Apparatus, may wish to consider the second option above. Local authorities are reminded of the need to comply with the Procurement Regulations if they are to be involved in the appointment of the surveyor (and the value of the appointment exceeds the relevant threshold) and to avoid inadvertently taking back risk.

494 Local authorities are also referred to the comments in Section 3 of this Part of the Procurement Pack on inventory changes during the bidding process.

Latent Defects Risk

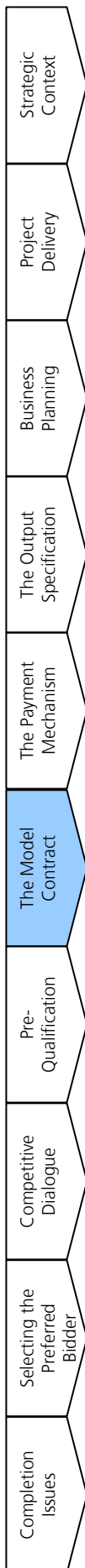
495 Section 6.5 SoPC covers latent defects risk. Risks in relation to latent defects will arise in any project where the service provider is taking on responsibility for 'deemed to comply' Apparatus or will be refurbishing existing Apparatus, as opposed to designing and installing new Apparatus. This issue will be compounded in the street lighting PFI projects where the service provider proposes to meet the requirements of the Output Specification by refurbishing a significant amount of street lighting Apparatus, or the deemed-to-comply Apparatus accounts for a large percentage of the total Apparatus.

496 The Model Contract included in this Procurement Pack assumes that latent defect risk will be transferred to the service provider (although there is no express provision to this effect). The approach that is appropriate in any particular Contract should be assessed in terms of the value for money for the local authority of the different options available, and in exceptional circumstances there may be a need to share latent defect risk.

497 The local authority must think through its approach to latent defects risk before commencing the procurement process, as this risk may significantly impact on the scheme costs, the value for money achieved and the procurement timetable. The factors that should be taken into account include:

- The nature and quality of existing data on the street lighting Apparatus
- The existing condition of the Apparatus
- The extent of any recent works carried out by the local authority
- Types of Apparatus in place within the local authority's area.

498 The local authority should identify in the Instructions and Guidance to bidders and Model Contract the approach that they believe will offer Best Value within the parameters of project affordability, bankability and a reasonable and realistic approach to risk allocation. Local authorities may also wish to invite bidders to offer alternative structures if improved value for money can be shown.



499 However, in all cases where the local authority expects to transfer latent defects risk, it should recognise that detailed survey work will need to be undertaken by the short-listed bidders, either alone or through a joint appointment, and this will need to be built in to the Bid preparation timetable.

Service Requirements and Availability, Maintenance, Performance Monitoring, Price and Payment Mechanism, Payments and Set-Off – Sections 7 to 11

500 Sections 7 to 11 of SoPC contain principles and approaches for dealing with service requirements, performance monitoring and structuring the payment mechanism.

501 Part 5 of this Procurement Pack provides detailed guidance on defining the services required for a street lighting project and developing the Output Specification. Part 6 of the Street Lighting Procurement Pack provides guidance on developing the payment mechanism for a street lighting scheme. Parts 5, 6 and 10 of this Procurement Pack include guidance on performance monitoring, and how this should be incorporated into the Output Specification and payment mechanism. The guidance in this Procurement Pack is consistent with SoPC.

502 Section 8.1 of SoPC includes required drafting on maintenance. The required drafting has been adapted to suit street lighting and incorporated into the Model Contract included in this Procurement Pack. However, given the Highway Act responsibilities and public use issues associated with the street lighting service, the lifecycle obligations associated with the street lighting Apparatus are likely to be a key issue for local authorities and these issues are dealt with further in Section 4 of this Part of the Procurement Pack.

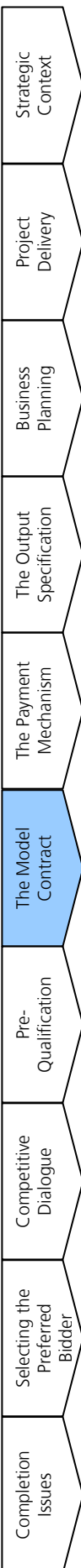
503 Section 8.5 of SoPC includes required drafting on surveys. The SoPC drafting is not considered to be relevant for a street lighting scheme given a local authority’s Highways Act responsibilities. The Model Contract and model Output Specification included in this Procurement Pack includes drafting that is considered more appropriate to a testing and inspection regime for a local authority’s street lighting service.

504 Sections 11.3 and 11.4 of SoPC include standard drafting on set-off and VAT respectively. The standard drafting has been incorporated into the Model Contract included in this Procurement Pack.

Change in Service – Section 12

505 The guidance contained in Section 12 of the SoPC is fully applicable to a local authority street lighting PFI contract. However, additional drafting has been included in the Model Contract and the payment mechanism to deal with variations associated with the accrual and de-accrual of items of Apparatus, such as through new developments (section 38, section 106 and section 278 agreements), road de-trunking or other adoptions.

506 One of the difficulties for a street lighting project in this respect is in dealing with the ‘capital’ and ‘operating cost’ consequences of such changes, and the Model Contract includes appropriate wording for evaluating and calculating both types of expenditure.



- 507 The guidance on developing the payment mechanism in Part 6 of this Procurement Pack, and the Model Contract, assumes that the change mechanism will deal with the consequences of a significant accruals or de-accruals such as a major road de-trunking, boundary changes, other major changes to the infrastructure and any capital expenditure requirements (such as the result of a new development needing street lighting), and that the 'operating cost' consequences of smaller changes (such as the adoption of a small number of street lighting columns) that do not cause significant changes to the risk profile of the service, will be dealt with as an adjustment to the Unitary Charge. Local authorities will need to consider the relevant thresholds for such arrangements and the consequence of such changes to the Unitary Charge.
- 508 If a local authority expects changes from a major local development, such as a Housing Market Renewal study, a large-scale regeneration project or major infrastructure developments, these will need to be considered carefully in the development of the Output Specification and Instructions and Guidance to bidders, and a decision taken on how to deal with this change in service in the Model Contract.
- 509 Section 12 of SoPC includes required drafting on change in service issues. The required drafting has been incorporated into the Model Contract included in this Procurement Pack, taking account of the above specific issues.

Change in Law – Section 13

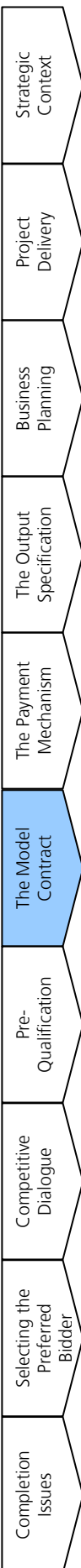
- 510 Section 13 of the SoPC deals with the definition and allocation of Changes in Law. SoPC recommends that discriminatory and specific changes in law (together referred to as 'qualifying changes in law') should be a local authority risk, and general changes in law a service provider risk or shared risk depending upon which provides the Best Value for the local authority. Part III of the *Standardisation of PFI Contracts – local authorities* amplifies the approach and allocates changes in law relevant to Best Value. Subject to the qualifications set out below, the guidance is equally applicable to local authority street lighting PFI contracts.

General Changes in Law

- 511 Local authorities need to assess whether general changes in law should be a service provider risk, or be treated as a shared risk having regard to the commentary in sections 13.7 and 13.8 of SoPC.

Specific Changes in Law

- 512 There are a number of changes in law that are specific to street lighting projects that have been dealt with as follows by the schemes in operation:
- Interpretation of Tax Law – interpretation risk on the service provider's position on the treatment of taxation allowances has been transferred to the service provider, which complies with SoPC. Further guidance on tax issues is provided in Section 3 of this Part of the Procurement Pack.
 - Changes in the measurement of energy consumption resulting from the Balancing and Settling Code Procedure (BSCP520) are considered to be outside of the control of the service provider and are treated as a Qualifying Change in Law in the Model Contract.



513 The following will not constitute a Qualifying Change in Law:

- Changes to the street lighting standards (see commentary in Part Four of this Procurement Pack), which is defined by reference to a list in the Model Contract. For example, future changes to the EN13201 have been transferred to the service provider, unless such changes are deemed to be retrospective in which case the costs of implementing the change are to be met by the local authority.
- A change in burning hours resulting from a change from EAC to PECU in the measurement of usage should be a service provider risk, and should not be included as a qualifying change in law.
- A change in EAC burning hours is likely to be minor and is therefore considered best treated as a service provider risk. This approach also encourages use of PECU in the measurement of usage.

514 Section 13 of SoPC includes required drafting on change in law issues. The required drafting has been incorporated into the Model Contract included in this Procurement Pack, taking account of the issues noted above.

Price Variations – Section 14

515 Section 14 of the SoPC contains principles and approaches for dealing with price variations, including indexation, benchmarking and market testing. These issues are relevant to local authority street lighting PFI projects and projects in operation or procurement have tended to include benchmarking and market testing for energy costs and service connections. Part 6 of this Procurement Pack provides guidance on developing the payment mechanism and incorporating appropriate price variations for a street lighting scheme.

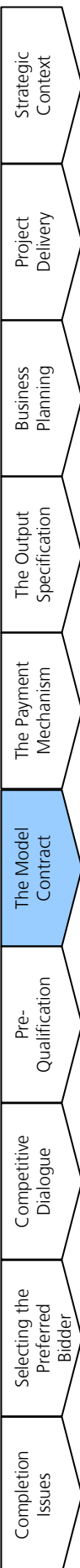
516 Section 14 of SoPC includes suitable drafting on market testing. Although the principles suggested in SoPC have been incorporated into the Model Contract included in this Procurement Pack, the suggested drafting on market testing is not deemed to be relevant to the benchmarking and market testing of energy costs and service connections where it is considered a simpler approach is required to match the more frequent timetable typically being adopted to test these aspects in a street lighting project.

Sub-Contractors and Employees – Section 15

517 The guidance in section 15 of SoPC on the issue of sub-contractors and employees is relevant to a street lighting project.

518 A number of local authority street lighting projects are likely to involve the transfer of employees under the Transfer of Undertakings (Protection of Employment) Regulations 1981 (TUPE), either involving the transfer of local authority employees or a 'second generation' transfer involving the transfer of employees from an existing service provider to a new service provider.

519 In developing the Output Specification and Model Contract, local authorities will need to consider how any specified training requirements and other employee requirements might be satisfied by the employees likely to be on the transfer list, and if there is a likelihood that the requirements cannot be met by the transferring employees at the service commencement date, to consider what arrangements might need to be put in place.



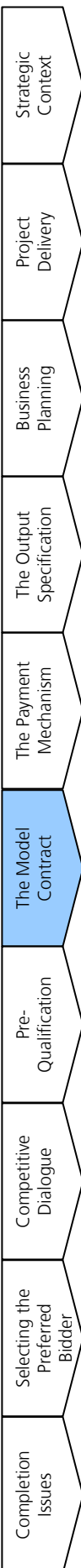
- 520 This will be particularly important if the service provider is to be expected to provide an emergency service from the date of service commencement and that only suitably qualified personnel are to be involved in those services. Any arrangements developed by the local authority must be in accordance with the appropriate legislation and regulations for the street lighting service.
- 521 In developing the Model Contract local authorities should also take account of the *Code of Practice on Workforce Matters in local authority Service Contracts* and the suggested Contract clauses. The suggested drafting from the Code of Practice has been incorporated into the Model Contract included in this Procurement Pack.
- 522 Bidders will expect appropriate information about the qualifications and experience of each potential transferring employee to be provided as part of the bidding process, and for an appropriate level of certainty over the numbers and details of transferring employees to be made available. Uncertainty over such details, or the absence of such information during the bidding process, will affect the ability of bidders to appropriately price their Bids. This information should not be warranted by the local Authority, but a mechanism is included in the Model Contract whereby the local authority compensates the service provider for any differences in the employee information previously provided.

Replacement of Sub-Contractors

- 523 Bidders often ask that a ‘wipe clean’ provision be inserted in the Contract on the basis that the HM Treasury letter of 14 April 2003 applies. This letter allows the service provider to replace the sub-contractor on a specified number of occasions – usually two. On replacement, all service default termination points (and sometimes all milestone default termination points) accrued up to the date the sub-contractor is replaced are cancelled at the service provider level. In addition, the new sub-contractor has a two-month grace period during which no default termination points will accrue.
- 524 The service provider has the right to replace sub-contractors who perform badly (with the consent of the local authority) in order to improve performance and avoid termination. To do this, the sub-contract will set a stricter termination threshold than that set out in the project Contract. If there are only one or two sub-contractors, it may be difficult to find a replacement sub-contractor prepared to accept an even lower termination threshold because of the poor performance of the previous sub-contractor, hence the need for some leeway, as set out in the HM Treasury letter.
- 525 In the street lighting Model Contract, although the number of milestone default termination points and service default termination points are low, the period over which they accrue is lengthy and, therefore, there is scope for the service provider to manage this in the sub-contract. A number of the street lighting projects have been completed and banked without a ‘wipe clean’ clause; the local authority should, therefore, resist any request to include a ‘wipe clean’ clause as it may result in the local authority having to suffer up to five years poor performance before it can terminate the Contract. This is unacceptable, particularly in the core investment period.

Assignment – Section 16

- 526 The guidance and suggested drafting included in Section 16 of SoPC relating to restrictions on the local authority assigning or transferring its rights or obligations under the Contract, applies to local authority street lighting PFI contracts.



527 Section 16.3(B) of SoPC includes required drafting on restrictions on transfer of the Contract by the local authority. The required drafting has been incorporated into the Model Contract included in this Procurement Pack.

Change of Ownership – Section 17

528 Section 17 of the SoPC deals with the issue of change of ownership of the service provider. These issues are relevant to a local authority street lighting PFI project and the Model Contract included in this Procurement Pack incorporates the required drafting on change of ownership.

Termination, Treatment of Assets on Expiry of Service Period and Surveys on Expiry and Termination – Sections 18, 19 and 22

529 Sections 18 and 19 of SoPC deal with the options open to a local authority at the end of a PFI Contract. Section 19.2 is particularly relevant, since as with a road, legal constraints prevent the private sector being the Highway Authority and owning the street lighting Apparatus. In a street lighting Contract the service provider will be given a licence to operate the relevant street lighting Apparatus, with such licences terminating at the end of the Contract term.

530 Section 19.4 deals with the handover provision for assets that transfer to a local authority and the Model Contract includes appropriate drafting in this respect.

531 A key issue for local authorities will be to identify the 'tests' that are required at the end of the Contract term to demonstrate that the specified requirements have been met. The street lighting projects in operation have specified hand-back requirements in terms of the residual life of the column element of the Apparatus (typically five years) and have developed risk sharing arrangements for the hand-back of 'deemed to comply' Apparatus. Under this approach, an independent expert tests the Apparatus 24 to 12 months prior to the expiry of the Contract.

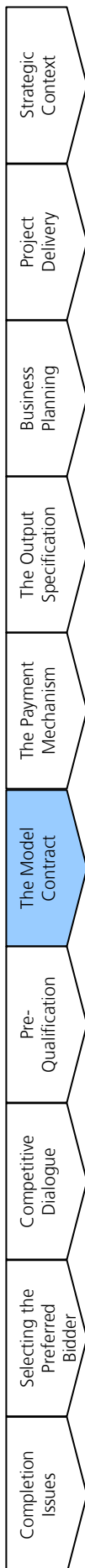
532 The choice of hand-back condition is an issue for local discretion and will be partly determined by the affordability of different options. The model Output Specification included in this Procurement Pack includes outline drafting on this issue for consideration by local authorities.

533 Sections 19 and 22 of SoPC include required drafting on the treatment of assets at the expiry date and on surveys on termination respectively. The required drafting has been incorporated into the Model Contract included in this Procurement Pack.

Early Termination and Calculation and Payment of Early Termination Payments – Sections 20 and 21

534 The approach set out in Section 20 of SoPC, supplemented by Section 5 of the *Standardisation of PFI Contracts – local authorities*, in terms of both events of default and consequences, is fully applicable to a local authority street lighting project.

535 As noted in paragraph 20.2.2.2 of SoPC, there may also be service specific issues. In the context of a street lighting PFI project, the local authority will need to consider how to deal with the following:



- Significant sub-standard performance, particularly as regards lighting outages in any one month or over, say, a three month period. The local authorities with street lighting projects in operation have determined appropriate performance targets for such (either as a specific performance target or linked to the percentage of payment deduction) with failure by the service provider to meet the relevant targets resulting in warning notices or ‘default termination points’. Items (l), (m) and (n) of the list of events leading to service provider default in paragraph 20.2.2.1 of SoPC will need to be amended to reflect the negotiated thresholds, and the terminology amended to reflect the specific tests relevant to a local authority street lighting project. However, the Model Contract does include a recommended number of defaults which would result in termination for Persistent Breach.
- Serious breaches such as a serious health and safety incident resulting in criminal conviction.
- The possibility of a persistent, unacceptable level of performance in relation to certain parts of the Service which is not covered by the payment mechanism, whilst performance across the remainder of the project is acceptable.

536 In the case of the latter issue, there is a need to ensure that the entire street lighting service receives an acceptable standard of performance. No parts of the street lighting service should have to suffer unacceptable standards over a sustained period. In such circumstances it is obviously not appropriate to ‘take-back’ parts of the service, and the payment mechanism and contract arrangements must ensure that such a situation can be dealt with, such as through the ratchet system of payment deductions and/or the award of service or performance points.

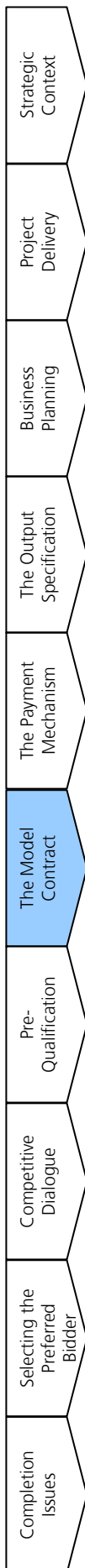
537 Financiers may have concerns about the exposure of the whole project funding to termination due to the service provider’s performance in relation to individual or distinct parts of the service. There will therefore need to be a clear incentive on the service provider to address the needs of the whole street lighting service included in the Contract if there is a risk of termination of the whole Contract for their performance in relation to part or parts of the Apparatus. In this way, the interests of the local authority, the service provider and financiers, are consistent, as the incentive on the service provider to prevent persistent poor performance on individual or distinct parts of the street lighting Apparatus is maximised.

538 Sections 20 and 21 of SoPC include required drafting on early termination and calculation and payment of early termination payments respectively. The required drafting has been incorporated into the Model Contract included in this Procurement Pack.

539 Local authorities should also have regard to the guidance in section 21.3 in SoPC (certainty of compensation amounts), which limits the circumstances in which the local authority’s termination liabilities can be increased without its consent.

Indemnities, Guarantees and Contractual Claims – Section 23

540 Section 23 of SoPC deals with the issue of indemnities, guarantees and contractual claims. These issues are relevant to a local authority street lighting PFI project. This Section of SoPC includes required drafting on indemnities and the required drafting has been incorporated into the Model Contract included in this Procurement Pack. Local authorities should note, in accordance with SoPC guidance, there is not a cap on the indemnities provided by the service provider. A local authority may consider a cap if it represents value for money but all bids should also be priced on the basis that there is no cap.



541 As noted in paragraph 23.3.7 of SoPC, the local authority may be faced with street lighting specific issues that require the local authority to offer a reciprocal indemnity. This should be requested and other mechanisms considered. If an indemnity is given by the local authority, it must be limited to the specific issue.

Insurance – Section 24

542 Section 24 of SoPC deals with the issue of service provider insurance. These issues are relevant to a local authority street lighting PFI project and the Model Contract included in this Procurement Pack incorporates the required drafting on insurance issues. Material damage insurance (and therefore business interruption insurance) and the corresponding provisions requiring a joint insurance proceeds account are not included in the Model Contract. The drafting on reinstatement has been used but adapted so it only applies where there has been widespread damage above a material financial value.

543 A key insurance and cost issue for local authorities is the applicability of material damage and reinstatement, and whilst these are not included on the list of required insurances for the standard bid in the Model Contract, local authorities will need to fully assess the value for money of including such insurance and take professional advice on how to deal with such issues.

544 As set out in 24.3.4, local authorities should also have regard to the HM Treasury Guidance on Insurance Issues on the sharing of insurance premium increases (the drafting for which is included in the Model Contract).

545 Local authorities should note that the issue of insurance is likely to be a difficult area and the local authority's Risk Management Officer should be fully involved in the drafting and negotiation of insurance issues. There are also a number of street lighting specific insurances that will need to be dealt with and local authorities must take their own professional advice on the scope of service provider insurances.

Information and Confidentiality – Section 25

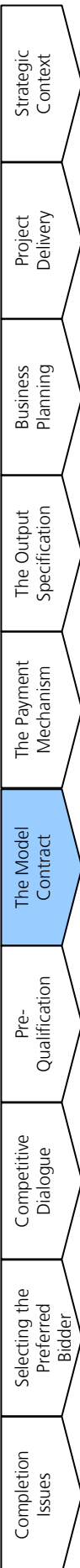
546 Section 25 of SoPC deals with the issues of information and confidentiality in a PFI Contract. These issues are relevant to a local authority street lighting PFI project and the Model Contract included in this Procurement Pack incorporates the required drafting.

Intellectual Property Rights – Section 26

547 Section 26 of SoPC deals with the issue of intellectual property rights. These issues are relevant to a local authority street lighting PFI project and the Model Contract includes appropriate drafting.

Dispute Resolution – Section 27

548 Section 27 of SoPC deals with the issue of dispute resolution. These issues are relevant to a local authority street lighting PFI project and the Model Contract included in this Procurement Pack incorporates the required drafting on dispute resolution.



Local authority Step-in – Section 28

- 549 Section 28 of SoPC deals with the issue of local authority step-in. The guidance on step-in is relevant to a local authority street lighting PFI project and the Model Contract included in this Procurement Pack incorporates the required drafting on local authority Step-In. In addition, drafting has been included in the Model Contract that makes an Emergency a Step-In Event.

Miscellaneous Provisions – Section 29

- 550 Section 29 of SoPC includes suggested drafting on miscellaneous contractual provisions. The Model Contract included in this Procurement Pack incorporates the required drafting from SoPC.

Direct Agreement – Section 30

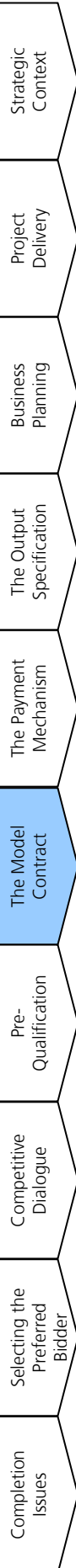
- 551 Section 30 of SoPC deals with the Direct Agreement. These issues are relevant to a local authority street lighting PFI project and the Model Contract included in this Procurement Pack incorporates the model Direct Agreement from SoPC; incorporating appropriate drafting to reflect the fact that local authority street lighting projects will include the provision of existing services alongside a relatively lengthy investment period.

Land and Property Interests – Section 31

- 552 Section 31 of SoPC deals with the issue of land and property interests. In a street lighting project the local authority will not be able to transfer interest in the land on which the Apparatus sits, although there will need to be drafting included in the Contract for giving a licence to the service provider to enable the service provider to carry out the service requirements set out in the Contract. The Model Contract includes appropriate drafting.
- 553 The use of licences rather than leases is a fundamental issue for the tax treatment of a local authority street lighting scheme and the issue of taxation is dealt with in section 31 of SoPC.
- 554 The Contract will need to include provisions for dealing with service provider access to third party land and, where relevant, for dealing with the transfer of depots, vehicles, plant and equipment. The Model Contract includes relevant drafting for access to third party land needed to install Apparatus which is deemed to be an Excusing Cause if it cannot be obtained.

Alternatives to and Variants of Project Finance – Section 32

- 555 Section 32 of SoPC deals with the alternatives to and variants of project finance. These issues may be relevant to a local authority street lighting PFI project and the local authority will need to take its own legal and financial advice on these issues where relevant, ensuring that such advice is sought from appropriately experienced corporate financiers and legal advisors with detailed experience of other similar structures.
- 556 4ps have produced a separate note that sets out a number of issues for consideration by local authorities in those instances where bidders have submitted bids that do not include a typical project finance structure, instead offering an alternative to or variant of project finance. A copy of the note is available from the 4ps project support team.



Commitment Letters – Section 33

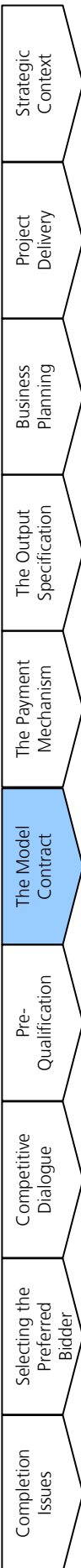
- 557 Section 33 of SoPC deals with commitment letters. The guidance and model commitment letter are relevant to a local authority street lighting PFI project and the local authority should ensure that the guidance is followed as part of selecting the Preferred Bidder. This Procurement Pack includes a copy of the model commitment letter from SoPC appropriately amended for a street lighting scheme (Model 12 – Preferred bidder Letter).

Due Diligence over Sub-Contracts and Financing Documents – Section 34

- 558 Section 34 of SoPC deals with the issue of due diligence over sub-Contracts and the financing documents. These issues will be relevant to a local authority street lighting PFI project and the local authority will need to take its own legal and financial advice on these issues.

Refinancing – Section 35

- 559 Section 35 of SoPC deals with the issues of refinancing. These issues will be relevant to a local authority street lighting PFI project and the Model Contract included in this Procurement Pack incorporates the required drafting from SoPC on refinancing.



Section 3

Contractual Issues not covered in *Standardisation of PFI Contracts*

Mobilisation Period and Tasks

560 Street lighting projects are likely to need to include a mobilisation period between financial close and service commencement, and as part of developing the Model Contract, the local authority will need to determine those tasks that the service provider needs to have satisfactorily completed before the service provider can commence the services. In the Model Contract these are referred to as the mobilisation tasks and the extent of such tasks will be for each local authority to determine and should be done in conjunction with the identification of any contractual 'conditions precedent'. The tasks should be documented in a mobilisation plan. The aim of the mobilisation plan is to ensure a safe and continuous level of service is provided at the point of transfer of service responsibilities. The list of tasks in the mobilisation plan should be kept to the minimum necessary, and might, for example, include the following activities:

- The health and safety and CDM obligations in the Contract have been met
- Sufficient personnel (including transferred employees) appropriately trained are in place to carry out the obligations under PS2 and PS3 of the Output Specification
- The existence of sufficient vehicles, stock, office, storage space and other service infrastructure to undertake the services
- The management information database as required under the Output Specification is in place and appropriate personnel are in place to operate the system
- The customer care system as required under the Output Specification is in place and appropriate personnel are in place to operate the system
- Appropriate consultation has been undertaken to ensure that all relevant parties have been informed of the new arrangements.

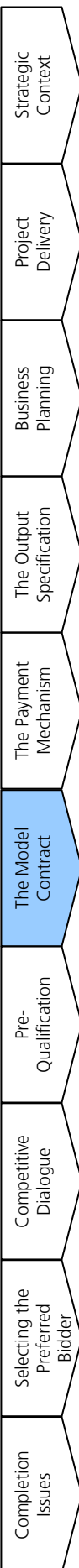
561 The Model Contract should also deal with the consequences of these mobilisation tasks not being completed by the planned service commencement date, and the local authority will need to give consideration during the bidding process to any fall back arrangements.

562 The Model Instructions and Guidance to bidders included at Model 9 of this Procurement Pack also makes reference to the need for bidders to submit a contractual Mobilisation Plan as part of their ISDS bid submission. Local authorities will need to determine how the bidder's Mobilisation Plan and list of mobilisation tasks should be agreed for the PFI Contract.

563 The Model Contract includes drafting dealing with mobilisation and commencement of the service.

Inventory Changes during the Bidding Process

564 There may be a need to agree mechanisms for compensating the service provider for changes to the street lighting inventory between the final tender price and service commencement. However, such a mechanism should not compromise the service provider's responsibility to evaluate and assess the condition and quantities of street lighting Apparatus transferring. The aim of the mechanism should be to only quantify those events that have caused changes to the street lighting infrastructure and that were not priced during the bidding process. Such events might include adoptions occurring under the Highways Act 1980, the Town and Country Planning Act 1990, the de-trunking of Highways Agency roads and/or boundary changes. The service provider should not be compensated for any errors in the Inventory.



565 The methods by which such changes to the Unitary Charge and financial models are governed will be a matter for local discretion and will be dependent upon the impact of such changes to the risk profile of the project. However, it is likely that in the majority of cases such changes will be capable of being dealt with as a quantity variation within the payment mechanism.

566 There is a detailed procedure for Accruals and De-Accruals (including pricing mechanisms) set out in the Model Contract.

Attachments to Lighting Apparatus

567 There is likely to be a range of attachments, both approved and illegal, that may be attached to the street lighting Apparatus. These attachments may include local authority approved notices (such as parking restrictions), election material, non-approved advertising material, hanging floral decoration, festival decorations and third party attachments such as bus stops and fire hydrant signs.

568 As part of developing the Model Contract, the local authority will need to determine:

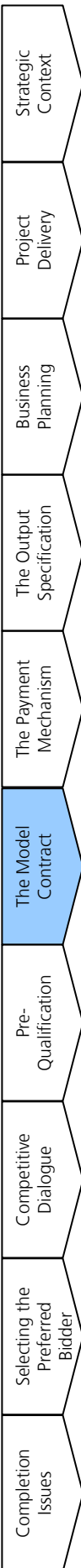
- What is allowable as an attachment, including what is allowable as a third party attachment
- Who is to be responsible for attaching to the street lighting Apparatus
- The arrangements for the notification and removal of non-approved attachments, including perhaps approved attachments after an agreed period of time
- The arrangements for dealing with the re-positioning of street lighting columns and the impact that will have on those attachments dealing with traffic regulation orders. This will need to include the arrangements for surveys, notification to the appropriate party, arrangements for re-siting the attachment
- Indemnities to be applied
- The co-ordination and liaison arrangements with the various stakeholders.

569 For festival lighting and floral decoration the bidders will want to know exactly what Apparatus is to be available for such purposes and the type of attachment proposed by the local authority since such Apparatus may need to have certain structural requirements. These obligations will need to be built in to the bidders pricing arrangements. Local authorities must be aware that any changes to the initial Output Specification (such as through an extension of the festive lighting area) will need to be dealt with through the change mechanism and may require additional funding to be provided by the local authority.

570 The Model Contract included in this Procurement Pack includes suggested drafting on attachments.

Advertising

571 A number of street lighting schemes have included specific arrangements in the Model Contract for allowing the service provider to advertise on a specified proportion of the street lighting Apparatus, and within defined advertising requirements. Including in the Model Contract the opportunity to allow the service provider to introduce third-party advertising to the street lighting Apparatus and to share the income with the local authority which can have a beneficial impact on the affordability of the street lighting service to the local authority. However, there are a number of sensitivities associated with this form of advertising, and whether or not to include such provisions in the Model Contract is a matter for local discretion.



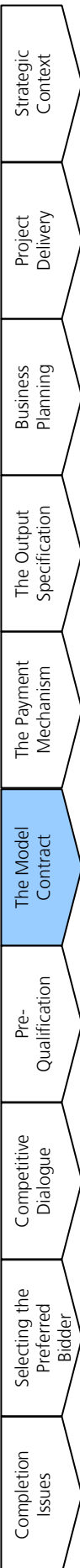
- 572 If advertising provisions are to be included in the Model Contract, the local authority will need to determine the obligations on the service provider, such as the need for planning permission, the restrictions on the extent of any advertising, the local authority rights to advertise in the vicinity and the restrictions on the type of advertising to be allowable as part of the Contract. It should be noted that the greater the level of obligations incorporated into the Model Contract, the more it will inhibit the service provider's ability to optimise income from advertising.
- 573 Arrangements will also need to be developed for the revenue sharing arrangements, which might include both a guaranteed sum to the local authority (as a reduction against the Unitary Charge) and arrangements for sharing revenues above certain levels of return.
- 574 The local authority will need to include clear instructions in the ISDS regarding any constraints and limitations relating to the way that bidder's might develop their proposals for advertising.
- 575 The Model Contract included in this Procurement Pack includes suggested drafting on third party income and advertising.

Telecommunications

- 576 As licensed telecommunications operators, the mobile phone networks have rights to install telecommunications equipment in/on the public highway, subject to Planning Authority approval. The Government recently announced changes to the planning arrangements and a copy of that guidance is available from the DfT (www.dft.gov.uk).
- 577 Given the growth in the requirements for telecommunications equipment, in particular to deal with the introduction of 3rd Generation (3G) communications, there is an obvious opportunity for street lighting Apparatus to be utilised for the telecommunications equipment. A number of local authorities appear to have agreed for limited use of their street lighting Apparatus for this telecommunications equipment and a number of the Variant Bids for the street lighting PFI projects in procurement have included proposals for such attachments. This is an obvious potential source of income to the service provider and therefore a reduction in the Unitary Charge payable by the local authority.
- 578 However, this is also a very sensitive issue and many local authorities are particularly concerned about the health aspects of such telecommunications equipment, particularly near locations such as schools. Local authorities will need to determine at an early stage, ideally as part of the business planning work, if telecommunications attachments will be incorporated and, if so, what restrictions will be incorporated. Members should be involved in such decisions, and the implications clearly set out. The affordability assessment in the OBC should reflect the proposed approach. The agreed approach will then need to be included in the Instructions and Guidance to bidders and Model Contract so that bidders can be clear as to what is acceptable in developing their proposals. Local authorities must not engage bidders in seeking out such opportunities from the telecommunications companies if such an approach is not acceptable to members.

Energy

- 579 The provision of energy is clearly not unique to a street lighting project, but the costs and risks associated with energy provision will often be a more significant element of a street lighting PFI Contract than will be the case in many other sectors. The cost of energy is likely to form a substantive element of total service costs and energy management is an important function in providing an efficient and effective street lighting service.



580 The issues are, in effect, questions of how Best Value is achieved, but separate issues arise in relation to

- Volume of use - how many units of energy (kWh) are needed to meet the Output Specification.
- The cost per unit of the energy purchased.

581 In relation to volume of use, the service provider will have taken over responsibility for the Apparatus and should be incentivised to design and operate the Apparatus to optimise efficiency of energy use. This guidance recommends therefore that the service provider should manage energy volume risk, as this provides a basis for an integrated Contract and ensures the service provider is incentivised to take advantage of changes in practice or technology that will bring about energy efficiency gains. The consideration of the installed energy load is critical to the design process and to the management of operational risks over time. Even though not all new street-lighting Apparatus is likely to be installed, nor are there always going to be reliable records of historic levels of use available, the service provider will be best placed to manage the risk.

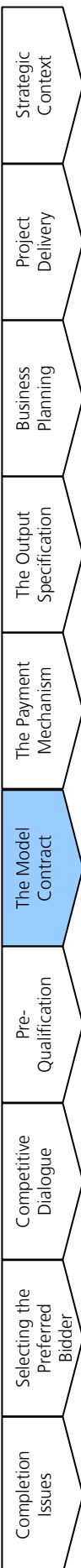
582 As technology develops there is the potential for energy consumption to fall significantly. The Model Contract is drafted on the basis that such a change would be dealt with under the change procedure; this ensures that there is not a windfall gain to the service provider.

Energy Price Indexation

583 Energy prices have been volatile over the last three decades and local authorities are left with a series of choices as to how to manage the risk associated with variations in energy prices during the Contract period. Each of these options has different strengths and weaknesses and Best Value considerations. These need to be carefully considered before determining the most appropriate option.

584 **Option 1** – Energy price changes are covered as part of the general indexation arrangements for the service, and indexation formulae are negotiated prior to the commencement of the Contract and subject to an annual adjustment in accordance with the terms of the PFI Contract. This approach assumes that the service provider is able to manage the price risk through long-term contracts for energy provision, at either fixed or index-linked prices to match the application of an annual adjustment to the Unitary Charge. The current market availability of fixed-price and index-linked energy contracts over 25 years is limited. Whilst such arrangements can provide long-term pricing certainty for local authorities, and are efficient to administer, they are likely to require either the energy provider or service provider to price for the management of this risk reflecting the difficulty of predicting changes in energy prices during the term of the Contract.

585 **Option 2** – Price changes are dealt with through a cyclical market-testing regime (typically this would be conducted either annually, every 3 or 5 years). In this guidance, market testing means the re-tendering on the market by a service provider of the energy supply for the Service. The result of the market testing process will result in an adjustment to the Unitary Charge. The local authority may wish to have the option to participate in the market testing process to ensure that it can test the value for money offered in comparison to its own market position. The choice of frequency for the market test should seek to balance the costs involved in undertaking the market testing process with an assessment of the risk in changes to energy prices. This option has the advantage of being able to better track price changes in the energy market, and hence reduces pricing risk, but it reduces pricing certainty compared to Option 1. It does however mean the local authority potentially taking back some risk.



586 **Option 3** – Another option is for the local authority to manage the provision of energy to the lighting infrastructure. This option may be appropriate if the local authority can demonstrate (in accordance with its duty to provide Best Value) that it can achieve more economic prices and that the costs of administration are lower than those of the service provider. However, this option does have the disadvantage that the service provider’s contractual responsibilities are reduced in scope, and the service delivery becomes fragmented. One effect of this is to reduce the incentive on the service provider to seek out and implement ways of reducing energy consumption. It also results in reduced risk transfer.

587 Local authorities may also wish to investigate how a **Cap and Collar** approach for energy pricing might be utilised to provide appropriate incentives to the service provider.

Treatment of existing contracts

588 The local authority’s existing energy contract(s) may span financial close and service commencement of the street lighting project. Assuming that the provision of energy will form part of the responsibility of the service provider under the Contract, then the first course of action should be to review the value for money offered by the existing contractual arrangements in comparison with those proposed by the service provider.

589 As part of this review, the local authority should determine if they are able to assign or novate the existing electricity contract to the service provider (there may be legal constraints to such an approach), and the impact of early termination including the potential liability of any breakage costs.

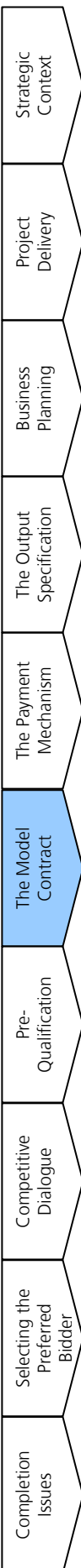
590 Where the service provider can offer a better arrangement than the existing electricity contract, these arrangements should be terminated at a time that achieves the best balance between the costs of termination and the reduced costs of the new arrangements. Where, as a result of competitive pricing or high breakage costs, the existing electricity contract offers better value for money, it should remain in place until it expires.

Electricity Supply Licenses

591 A number of bidders have raised the question about the need for an electricity supply licence. This issue has been discussed with OFGEM and the advice at the time was that local authorities are unlikely to need any additional licences as a result of entering into a PFI Contract for the provision of the street lighting service. Similarly, OFGEM did not expect the majority of service provider’s to require any additional licences since they will in most instances be a customer or supplier for the supply of electricity.

592 However, some bidders believe that there may be instances where the service provider will require electricity supply licences to be procured as part of developing the project, for example in those instances where the service provider is setting up a special purpose company that is not covered by other licences, such as the Parent Company Supply Licence. In these instances the service provider may need to arrange additional licences as part of developing the project. The cost of procuring such licences is not expected to be a significant cost to the project and all costs should be borne by the service provider.

593 Local authorities will need to undertake their own due diligence checks to ensure that all of the relevant licences are in place before a Contract is signed.



Unmetered Supplies User Group

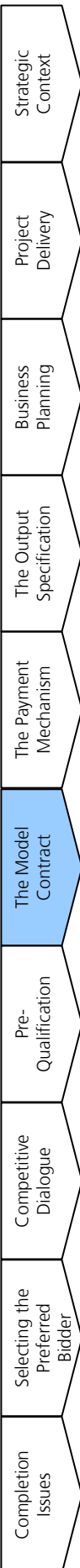
- 594 The Unmetered Supplies User Group (UMSUG) is currently reviewing the balancing and settlement Code Procedure (BSCP 520) and the electricity consumption of unmetered Apparatus. It is possible that this process will result in changes to the energy consumption rating of unmetered Apparatus.
- 595 This issue obviously presents a risk to the service provider which it may find difficult to manage and/or price. The Model Contract specifies that any change to BSCP520 (whether foreseeable or not) is treated as a Qualifying Change of Law. However, local authorities will need to evaluate the value for money offered by different risk allocation models and this is a matter for local discretion.

New Roads and Street Works Act (NRSWA)

- 596 As part of developing the Model Contract, local authorities will need to determine the status of the service provider, as either an agent or utility, and any Section 74 or Traffic Management Act powers that might be 'contracted out' to the service provider. The local authority will also need to determine how compliance with NRSWA will be monitored, any proportionality issues (Section 86(3)) and the extent of record keeping expected of the service provider.
- 597 Although these issues will be a matter for local discretion, the Model Contract includes appropriate drafting on NRSWA issues.
- 598 The local authority should also agree a regime for giving of notices before commencing street works that is acceptable to their Highways Department.

De-Regulation of Connections Work

- 599 This remains a difficult area and given the uncertainty of the position, and local authorities must take care when drafting the provisions relating to the deregulation of the service connections market.
- 600 In summary, the position at the present time is that there has been some relaxation of the market for service connections and a scheme known as 'Rent-a-Jointer' or the 'One-Stop-Shop' has been introduced by OFGEM. This should mean that a service provider is able to negotiate with the relevant Distribution Network Operator (DNO) a reasonable arrangement for service connections.
- 601 There is still an expectation that further deregulation of the service connections market will be enacted by OFGEM and, assuming the appropriate regulations are passed, a registration scheme will come into operation allowing any service provider meeting the registration standards to undertake some services connections works. However, it remains somewhat uncertain at the present time as to whether the new scheme will be introduced in accordance with the OFGEM proposals
- 602 Local authorities should consider including in their Contracts appropriate provisions for dealing with future changes in this regard, in particular appropriate provisions for benchmarking and market testing. However, in determining such an approach the following issues need to be considered:



- Is an incentive mechanism needed in the Contract to encourage the service provider to look for savings during the Core Investment Period? This might for example include a sharing of any savings.
- The drafting in SoPC for benchmarking and market testing is aimed at soft services being 'tested' about every five years. Such drafting is considered to be too cumbersome for the purposes of service connections, where a more regular (such as every 12 months) and more simplistic approach to market testing is considered more appropriate.

603 The Model Contract includes sample drafting on the issues associated with deregulation of the connections market and local authorities are advised to consider this in the light of their own schemes, and the latest developments in this area.

Taxation

604 The recommended approach in relation to the treatment of changes in tax law for these schemes varies from the approach suggested in SoPC. In particular, the proposed arrangements for street lighting schemes involve the service provider bearing the risks of:

- Their proposed tax treatment being held not to apply at any time after service commencement and tax law or practice changing such that the treatment fails at a later stage.
- The uncertainty regarding the tax status of expenditure on street lighting Apparatus rests on the definition of the expenditure required for refurbishing and/or replacing lighting Apparatus.

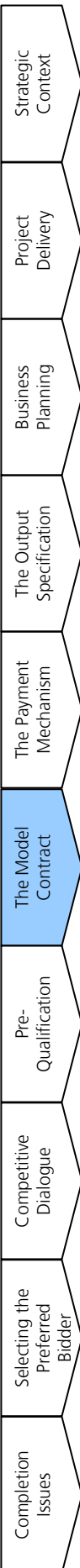
Capital Allowances

605 If the expenditure incurred by the service provider on this Apparatus is capital expenditure, the question of whether capital allowances are available occurs. Capital Allowances are available in respect of plant and machinery but it appears likely that the nature of the Apparatus being used in a street lighting scheme renders it outside the definition of plant and machinery. Instead it appears likely that the Apparatus will be treated as fixtures. In the case of fixtures, capital allowances are only available if the body incurring the expenditure has a sufficient interest in the land to which the fixtures are attached, in this case the streets on which the columns are located.

606 It would seem to be the case that a local authority, as the Highway Authority, has an interest in the land as they have certain easements and implied licences. However, it is unlikely that the local authority can grant a sufficient legal interest to the service provider.

607 Street lighting PFI projects generally involve the granting of a licence to the service provider in respect of the Apparatus; as the streets and roads are public highways no other licence is needed. For the same reason, the granting of an easement over the land in question is inappropriate.

608 Under normal circumstances therefore the capital allowances route has not been used by potential service providers.



Other Approaches

- 609 The service provider may account for the services delivered under the Contract as a finance lease such that the service provider can obtain full revenue deductions for the Apparatus and associated costs in the year in which the costs are incurred. Such a treatment will also bring forward the recognition and hence the taxation of income but is considered to be beneficial overall. However, the availability of relief under this treatment depends upon the specific circumstances of the project supporting the necessary accounting treatments for both the service provider and the local authority. This matter has been the subject of Inland Revenue guidance regarding composite trade.
- 610 Given the significance of tax relief on the Apparatus and associated works to the viability of a street lighting project, it is important that local authorities seek to gain as much comfort as possible during the procurement process. In particular, local authorities should ascertain that the bidders' proposed tax treatment is supported by:
- An opinion letter from the bidders' external auditor and financial advisor that the proposed treatment is within UK GAAP and does not constrain the ability of the local authority to achieve an off-balance-sheet treatment in accordance with Financial Reporting Standard 5.
 - Where appropriate this should be supplemented with advance tax clearance (under Code of Practice 10) from the Inland Revenue for the proposed treatment before Contract signature.
- 611 Local authorities must seek their own financial advice as to the risks attached to particular treatments in evaluating Bid submissions.

Value Added Tax

- 612 It is expected that the Unitary Charge payable by the local authority will be subject to VAT as in the case of other local authority PFI projects. This is because the amount payable is taken to be a consideration for a composite supply made by the service provider which will generally be a standard rated supply for VAT purposes.
- 613 The service provider will therefore expect the PFI Contract to provide that payments are:
- Calculated on a VAT exclusive basis
 - Grossed-up where necessary to reflect the fact that the service provider will have to account for VAT on such payments.
- 614 The ability of the local authority to recover the VAT incurred on the Unitary Charge will be determined in the usual way in accordance with section 33 of the Value Added Tax Act 1994. Generally, local authorities are empowered by section 33 to recover from HM Customs and Excise the VAT that they incur on the provision of services that are considered to be non-business activities.
- 615 Following the guidance published by HM Customs and Excise, it is likely that the provision of street lighting would be considered to be a non-business activity. Therefore the VAT incurred should be recoverable by the relevant local authority.

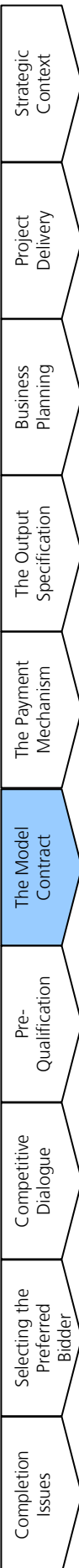


Sub-Contractors in the Construction Industry Scheme

- 616 The Construction Industry Scheme applies to Contracts under which one party is obliged to carry out certain construction operations for the other party. It requires persons making payments for the carrying out of construction activities to deduct an amount at source from those payments in respect of tax and national insurance contributions, and to account for the amount so deducted to the Inland Revenue on behalf of the recipient of the payment. The obligation to make such deductions can be avoided by the recipient providing certain documentation to the payer.
- 617 There is still considerable doubt over whether, and if so to what extent, this scheme applies to PFI projects generally. Whilst clearly most PFI projects involve a material element of construction, and therefore the scheme would seem to apply, there are strong arguments that what the local authority is actually paying for is an on-going service provided by the service provider. The Inland Revenue has yet to publish any definitive guidance on the subject.
- 618 General practice is to include provisions to cover the operation of the scheme. These mainly seek to give the local authority comfort that should the Inland Revenue insist on the operation of the scheme, the local authority has contractual rights to make relevant deductions from the Unitary Charge as and when required to do so by law, subject to the provision by the service provider of the necessary documentation to enable the local authority to make the payments without the deduction.
- 619 In relation to street lighting projects, the element of construction included within the service provider's obligations under the PFI Contract is clearly less significant than in projects that include the construction of major structures such as roads. That said, the definition of 'construction operations' used in the legislation is wide, and refers to, inter alia, the construction, alteration, repair of buildings, structures and works forming part of the land.
- 620 The local authority would, therefore, be taking an unnecessary risk were it to agree not to include appropriate provisions in the PFI Contract. The provisions should follow those used in other PFI projects, but it should be ensured that they reflect the scheme in its current form (and particularly in the light of the major reforms to the scheme implemented in 1999 which are still not reflected in the wording used in many PFI projects).
- 621 The Model Contract includes appropriate wording.

Stamp Duty

- 622 Stamp duty is generally only payable on documents that operate to vest or transfer title in any property. In street lighting projects, title in the Apparatus generally remains with the local authority, and therefore the impact of stamp duty should be minimal. Where new Apparatus is acquired by the service provider, title is transferred to the local authority by the operation of contractual provisions. No special exemptions from stamp duty exist for local authorities arising from their status as local authorities.
- 623 To the extent that any land is transferred to the service provider - for example depots or storage yards - then stamp duty may become payable. However, it is usually the case that such land is transferred, or more likely leased, to the service provider for a nominal consideration with the transfer document, or leases, therefore attracting only nominal stamp duty.



Grossing-up of Payments

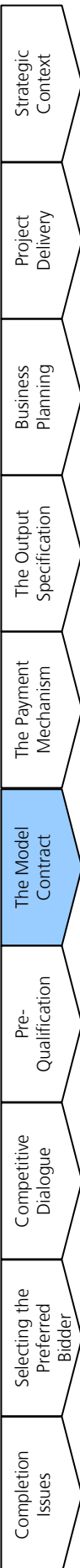
- 624 It is envisaged that where a termination results from default by the local authority, force majeure or corrupt gifts or fraud, the termination payment to the service provider is subject to taxation in the hands of the service provider. The local authority would gross-up the payment so that the service provider is left with the same amount of money after payment of that taxation as it would have had, had the payment not been subject to any taxation.
- 625 This is to ensure that, as far as possible, the intended purpose of the termination payment is satisfied. That is, that the service provider and its financiers are fully compensated, that the financial consequences of termination be shared, or that senior debt is repaid, depending on which termination event applies and what has been commercially negotiated between the parties.
- 626 Grossing-up should also apply to any payments by way of indemnity or compensation made by the service provider to the local authority.
- 627 The payment should take account of any relief from taxation available to the service provider that has been derived from the particular PFI project in the usual way, and subject to the financial model. Clearly, if the service provider has priced the project on the basis that tax relief is available for surrender to group companies, then the local authority will already have had the benefit of that relief by way of a lower Unitary Charge. It should therefore still gross-up the termination payment accordingly.
- 628 The Model Contract incorporates the suggested drafting on grossing-up of payments from SoPC.

Access and Parking enforcement

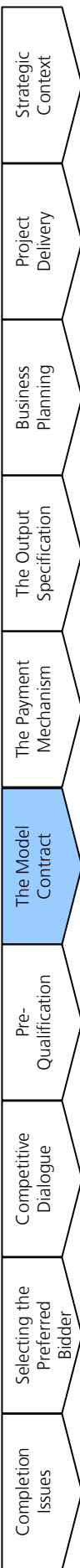
- 629 In some local authorities (particularly those in densely populated urban environments) the issue of access to lighting Apparatus as a result of vehicles parked (either legally or illegally) at the kerb-side may be problematic. In particular, parked vehicles may prevent the service provider from providing the contracted services.
- 630 In such cases, the service provider may seek relief for not being able to complete services in accordance with the Output Specification and performance targets. In such circumstances, the local authority has the discretion (subject to vires) as to whether to include the enforcement of parking restrictions as a responsibility of the service provider, or to ensure that the service provider has an obligation to inform the local authority of the existence of parking violations. However, the service provider should not be granted relief from carrying out any part of the service or from deductions being imposed.
- 631 The former route probably best protects the local authority and assists the service provider but would need to be considered in the context of local organisational and contractual arrangements as well as the vires of such a course of action.

Lifecycle Replacement Issues

- 632 The Relevant Standards outlined within the guidance on developing the Output Specification (see Part Four of this Procurement Pack) should include standards for the structural and mechanical integrity of the lighting infrastructure.



- 633 The service provider is liable for any damage/injury caused through failure of the lighting Apparatus and should be incentivised to manage the Apparatus safely and efficiently over the life of the Contract. The Model Contract will also have a range of obligations in relation to the hand-back and residual life of the Apparatus at the end of the Contract period.
- 634 However, to protect the local authority from the service provider storing up risks in the latter years of the Contract, through a failure to replace the Apparatus on a programmed and safe basis, there should also be financial and contractual mechanisms to incentivise the service provider to manage this risk effectively. This is particularly the case where the service provider has made extensive provision for life-cycle replacements during the period of the Contract.
- 635 In order to provide the best protection to the local authority, the Output Specification should provide for equipment design and installation standards that apply throughout the Contract period and ensure that an appropriate standard of equipment is used throughout the Contract period.
- 636 The Output Specification and payment mechanism should also incentivise the service provider to manage the Apparatus safely through a range of maintenance-based targets and obligations. In particular, the planned maintenance obligations in respect of the Apparatus in accordance with Performance Standard 2 in the model documentation requires the service provider to cyclically inspect the structural, mechanical and electrical integrity of the Apparatus, and to use the results in a risk assessment that feeds into the annual column replacement programme.
- 637 Whilst the method of inspection is subject to the service provider's contractual Method Statement (to maximise innovation), the aim of this process is to ensure that the service provider operates a rigorous risk assessment process such that lighting is replaced as it starts to deteriorate. There is a range of proprietary risk assessment systems that could be used for these purposes.
- 638 Where an item of Apparatus is categorised into a higher risk category, it is intended that this should then form part of the service provider's annual life cycle replacement programme that is subject to a range of financial and contractual incentives. The annual programme should be subject to the review procedure and evaluated by the local authority in the context of the service provider's financial model and audit of the risk assessment process.
- 639 Through the payment mechanism, financial deductions will be made in the event of the service provider falling behind the investment programme. These deductions should escalate at a level such that the service provider is motivated to recommence and speed up the programme once they have fallen behind. The use of this mechanism should be sensitive to avoid the risk of 'hair trigger' deductions.
- 640 The level of deduction applied should match or marginally exceed the net annual saving achieved by not complying with the programme to ensure that the service provider is fully incentivised to complete the works. The level of deduction applied will, therefore, need to be set locally in accordance with a service provider's financial model.
- 641 In addition, the local authority should consider the following mechanisms to provide full protection throughout the Contract period:
- Provisions within the financing and banking agreements, which will be dependent on the contractual structure and financing approach put forward by and negotiated with the service provider.



- The use of a service points or default termination points regime to provide the local authority with the ability to terminate the Contract on the basis of service provider default once the works have fallen significantly (and persistently) behind programme.
- The use of retention funds on expiry of the Contract.

642 The local authority and its advisors should supplement this regime with careful review, evaluation, and where appropriate dialogue on:

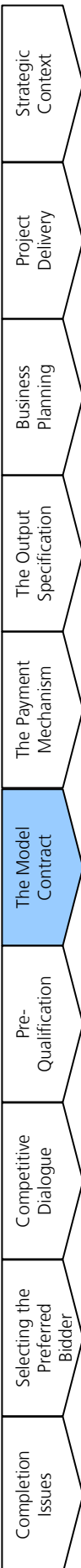
- The integrity of the service provider’s technical design solution and its ability to meet the performance obligations as set out in the Output Specification.
- The extent, assignability and robustness of warranties provided by the design sub-contractor to the service provider
- The banking agreements to ensure that the service provider is motivated by the terms of the funding agreements to carry out replacement works.
- The contractual default termination provisions (especially the division between senior debt and equity in the service provider’s funding arrangements) to ensure that, taken together with the PS1 deductions, the local authority is never exposed to a position where it has paid more in Unitary Charge to the service provider than it has received in value.
- The potential effects of refinancing on the proposed arrangements.
- The cost reductions/improved risk management arrangements arising to the benefit of the service provider by the use of newer Apparatus.

643 The Model Contract contains suitable drafting on many of these matters to ensure a continuing high standard of service.

Client Side Monitoring, Audit and Inspection

644 As part of developing the Model Contract, local authorities will need to give appropriate thought to the arrangements for monitoring the performance of the service provider, the arrangements for review and partnering meetings, and access arrangements for both the local authority’s officers, the Auditors and the Best Value Inspector.

645 The Model Contract includes appropriate drafting on these issues but it is suggested that local authorities develop, ideally as part of the ISDS, a matrix that summarises the proposed arrangements and agree the proposals with all stakeholders.



**STREET LIGHTING
PROCUREMENT PACK
PART SEVEN
PRE-QUALIFICATION**

Strategic
Context

Project
Delivery

Business
Planning

The Output
Specification

The Payment
Mechanism

The Model
Contract

Pre-
Qualification

Competitive
Dialogue

Selecting the
Preferred
Bidder

Completion
Issues

Contents – Part Seven – Pre-Qualification

Section 1
The Pre-Qualification Process

Section 2
Advertising the Project

Section 3
The Descriptive Document and Bidders Conference

Section 4
Pre-Qualification

Also relevant to this Part Seven of the guidance is:

- **Model 5 – Descriptive Document**
- **Model 6 – Pre-Qualification Questionnaire**
- **Model 7 – PQQ Evaluation Framework**
- **Model 8 – Pre-Qualification Correspondence**

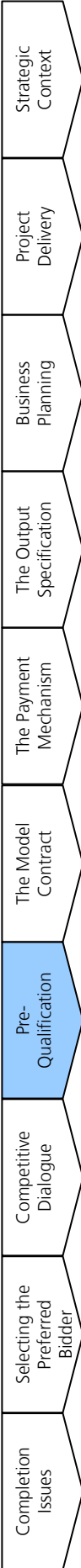
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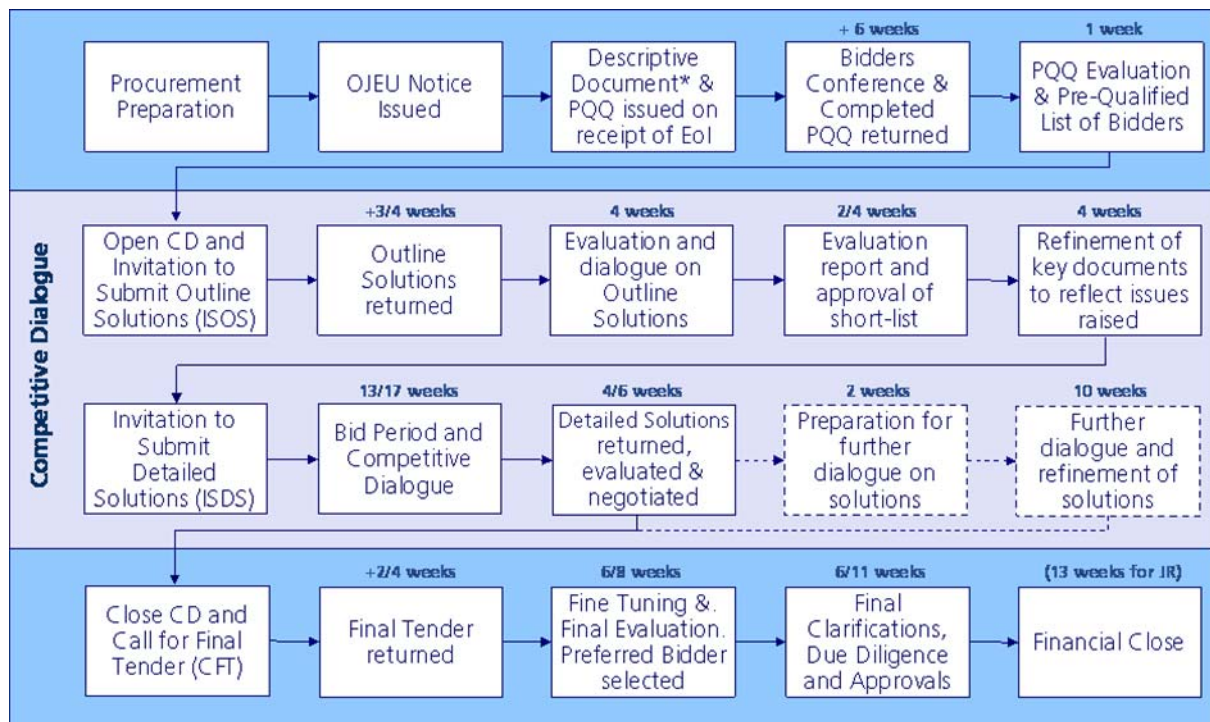
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Section 1 The Pre-Qualification Process

646 Once members of the local authority and the PRG (where the local authority is seeking central government support towards the costs of the project) have approved the OBC, the formal procurement process can start. An overview of a typical procurement process for a PFI/PPP scheme under the competitive dialogue process is shown in figure 7.1.1.

Figure 7.1.1 – Overview of the Procurement Process



647 This Part of the Procurement Pack includes guidance on the initial stages of the procurement process, from advertising the project through to determining the list of pre-qualified bidders. Parts Eight to Ten of the Procurement Pack include guidance on the subsequent stages.

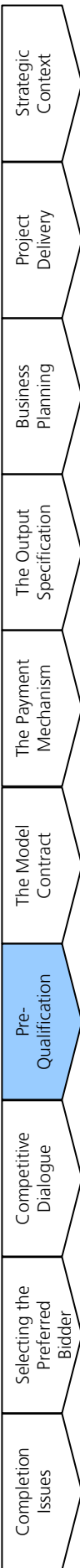
Getting Started

648 Whilst it is theoretically possible to commence the procurement process immediately following approval of the scheme, local authorities must first ensure that :

- The project management arrangements are in place for delivering the project, including the appointment of any external advisors deemed necessary to support the in-house team
- A realistic and achievable project timetable has been finalised and agreed by the project team, project owner, and the strategic project board
- An internal communications strategy is in place to keep key stakeholders, such as employees, Members, staff representatives, and affected service departments informed about progress of the project

- Key project documentation, such the Descriptive Document, Pre-Qualification Questionnaire, Invitation to Submit Outline Solutions (ISOS), Output Specification, Payment Mechanism and Model Contract, are in place
- A detailed condition survey of the assets or infrastructure associated with the project, a comprehensive inventory of items to be included in the project, and other data relating to project are all in place (and available to potential bidders through a collaborative website or data room)
- There is a clear plan in place for completing any land acquisition and statutory processes, and the plan is properly tied in to the planned procurement arrangements.

649 Time should be spent on developing the key documentation for the project in advance of the OJEU Notice so that the advertisement accurately reflects the scope and nature of the project. This will avoid the possibility of having to re-advertise at a later stage, and also avoid a lengthy period be necessary for developing documentation between completion of the short-listing process, and the issue of the Invitation to Submit Detailed Solutions (ISDS), which could lead to losing short-listed bidders. Four weeks should be the aim for this period, during which a clarification meeting can be held with each short-listed bidder to explain the subsequent stages of the procurement process and the structure of the ISDS and bidding process. It will also enable key issues identified from the pre-qualification and short-listing stages to be incorporated in to the ISDS (subject to the Procurement Regulations). The outline project timetable included in this Procurement Pack assumes that draft documentation will be in place before procurement commences.



Section 2 Advertising the Project

650 The formal procurement process begins with the publication of a Contract notice in the Official Journal of the European Union (OJEU Notice). Key issues for consideration at this stage include:

- Is it necessary to issue a Prior Information Notice (PIN)?
- The procurement route and procedure to be used
- Drafting and placing the Contract Notice for OJEU.

Prior Information Notice

651 The local authority must determine if it is necessary to issue a PIN for the project, which informs the market that such a project is being developed and is likely to be formally advertised in an OJEU Notice in due course. Where a project involves a relevant works contract, the awarding local authority is required to publish a PIN in the Official Journal "as soon as possible after the decision approving the planning of the works contract".

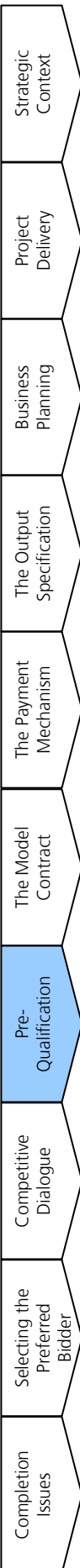
652 For schemes advertised as a Services Contract under the Public Contracts Regulations 2006, it is not mandatory to place a PIN that is specific to the scheme. However, service PINs are required in respect of service categories on an annual basis and should have been placed at or around the start of the financial year. A PIN which is specific to a particular scheme may still be placed on a voluntary basis, using the standard format and providing detailed information in the 'other information' section in order to gauge the level of market interest and give advance notification of the scheme.

653 Where a PIN has been issued as a way of commencing a soft market testing exercise (see Part Three of this Procurement Pack) the local authority should determine if it is necessary to issue a further scheme-specific PIN. Where a scheme-specific PIN has not been issued, it may be opportune to consider the issue of a PIN immediately following approval for the project, giving an indication of when the formal procurement process is likely to commence.

654 There is a mandatory form of PIN and standard forms are available from the Office for Official Publications of the European Union in Luxembourg (<http://simap.eu>). These can be completed on-line using the standard template available. The format of any PIN issued must follow that required by the Procurement Regulations and legal advice should be sought on the drafting of a PIN.

OJEU Notice

655 A Contract Notice must be placed in the OJEU for schemes that have a value above the thresholds set out in the Procurement Regulations. The form of the OJEU Notice will depend on which Regulations apply and which contract award procedure is to be used. The Public Contracts Regulations 2006 will be relevant to local authorities involved in PFI and PPP projects. These Regulations enact EU directives as part of UK law. For the procurement of local authority PFI and PPP projects, local authorities should only need to refer to the EU directives if there is uncertainty over the interpretation of the UK Procurement Regulations.



Works, Services or Supplies

656 The EU has now adopted a new procurement Directive which consolidates and simplifies the separate Directives covering works, services and supplies. The new Directive (2004/18/EU) has been implemented in the UK by the Public Contracts Regulations 2006. The choice of whether to advertise as works, services or supplies contracts is not normally critical, but the following should be noted:

- The financial thresholds for works are different from those for services or supplies
- The use of the negotiated procedure is only available in exceptional circumstances set out in derogations; such derogations differ between works and services contracts. This issue, however, has less relevance following the introduction of the competitive dialogue process which is expected to be the procurement route used for the majority of local authority PFI and PPP schemes post January 2006 (this Procurement Pack is drafted on the basis that the competitive dialogue process will be used).

657 Many local authority PFI and PPP projects are likely to encompass a combination of works, services and supplies. It is unlikely, however, that a PFI or PPP project would be categorised as a 'supply' contract. Assuming the project is not classified as a supplies contract, a local authority must decide whether to advertise the project as a 'works' contract or as a 'services' contract as defined under the Public Contracts Regulations 2006.

658 Where a contract involves both works and services, it is necessary to consider the main objective of the overall Contract. On the one hand a service project might involve a component of rehabilitation work to the local authority's assets or infrastructure, which, if left as a stand-alone contract might be considered to be 'works'. On the other hand, these works are likely to take place during only a relatively small period forming part of the PFI Contract. The dominant part of the contract (both in terms of its purpose, and the value involved) might be the subsequent operation and management of the local authority service (although that itself would normally necessitate some works). This is a matter on which the local authority must make a judgement in the context of its own scheme.

659 Local authorities should take their own legal advice on the route most appropriate to their particular scheme to avoid any potential breach of the Procurement Regulations. The guidance in this Procurement Pack assumes that the scheme can take the 'services' route.

Contract award procedures

660 The four procedures that are available for the award of works, services and supplies contracts under the Procurement Regulations are the open, restricted, competitive dialogue and negotiated procedures, the main characteristics of which are set out in figure 7.2.1.

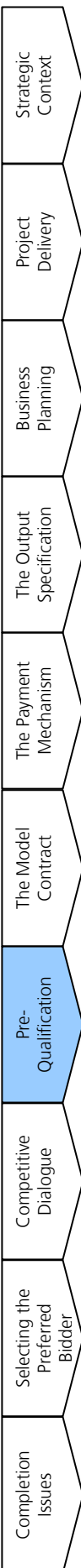


Figure 7.2.1 – Contract Award Procedures

Open – this procedure requires that any bidder responding to the OJEU Notice should be invited to tender for the advertised contract. The procedure does not allow pre-qualification so it can attract an unwieldy number of potential bidders. The open procedure is recommended only for simple contracts and therefore tends to be unsuitable for PFI projects. It is not likely to be suitable for local authority PFI/PPP schemes

Restricted – this procedure allows local authorities to select a limited number of bidders from all of those that respond to the OJEU Notice who are then invited to tender. However, the ability to hold discussions or negotiate with bidders is limited to issues of clarification. There is, therefore, only limited scope for meaningful discussions

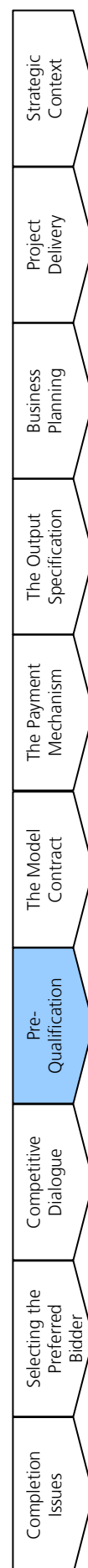
Competitive Dialogue – this is a new process introduced specifically to facilitate the procurement of ‘particularly complex projects’, for example PFI and PPP projects. The competitive dialogue process is expected to be used for most local authority PFI and PPP projects post January 2006

Negotiated – Under this procedure, local authorities are permitted to pre-qualify those that respond to the initial OJEU Notice and to select a number of bidders with whom to invite to tender. Use of the negotiated procedure is not an automatic right of the local authority; it can only be used in certain exceptional circumstances specified in the Procurement Regulations and local authorities are legally obliged to justify their selection of the negotiated procedure.

- 661 Prior to January 2006, PFI schemes were typically advertised under the negotiated procedure, despite its exceptional nature, as this procedure allows detailed discussions and negotiations with bidders as part of the procurement process. From 1 February 2006, it has been possible for local authority PFI and PPP schemes to be advertised using the competitive dialogue procedure. However, the choice of procedure will be decided on a scheme-by-scheme basis, and local authorities must always take legal advice on this issue. An audit trail should be put in place which documents the decision to use the competitive dialogue procedure (or other procedure) and the reasoning behind this.
- 662 The OJEU Notice should indicate where the procurement falls within the Procurement Regulations, and the procurement regime (works, services or supplies) and procedure (open, restricted, competitive dialogue or negotiated) that is to be used.

Other Issues for the OJEU Notice

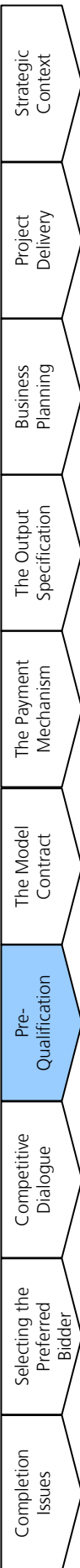
- 663 The use of a standardised form of OJEU Notice is mandatory. The standard forms are available from the Office for Official Publications of the European Union in Luxembourg (<http://simap.eu.int>).
- 664 Attention must be paid to the detailed drafting of the OJEU Notice. The OJEU Notice sets the parameters for the whole project and should include sufficient explanation of the project to attract bidders. It should give details of the scheme as envisaged, and indicate the volume and scope of the services required; either expressed in terms of project details and/or expected monetary values of the project. If collaborative working with another local authority is envisaged, thought needs to be given to how the contracting authority is described in the OJEU Notice, and to ensure that all local authorities participating in the project are named.
- 665 If the scope of the project alters from that set out in the OJEU Notice, it may be necessary to re-advertise the scheme and start the whole process again. If the OJEU Notice is drafted with sufficient flexibility, it may be possible to cater for subsequent change, although a balance must of course be struck between the desire for flexibility and the need to provide potential bidders with an adequate description of the local authority’s requirements, avoid discrimination, and ensure that the fundamental procurement principles of transparency and equality are observed.



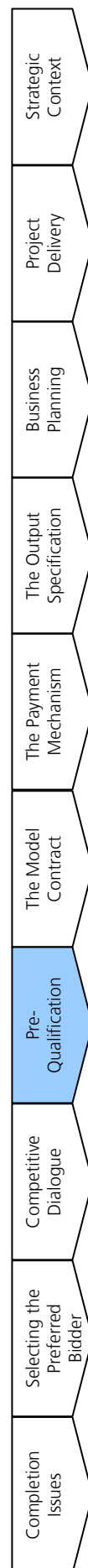
- 666 The OJEU Notice should include details of the conditions for participation (pre-qualification) and the information required from bidders that will be used to assess their economic and financial standing and technical capacity and ability.
- 667 The OJEU Notice should set out the award criteria for the Contract. Local authorities have a choice of award criteria, either lowest price or the most economically advantageous tender. The 'most economically advantageous tender' is typically chosen for PFI and PPP schemes. The Regulations leave it to the local authority to determine the factors for most economically advantageous tender, although they do include a non-exhaustive list of factors that the local authority can use for this purpose. The relative weighting of the evaluation criteria must be stated in the OJEU Notice or the Contract documents; weightings can be expressed by providing a range within an appropriate maximum spread. The duty to specify the criteria in advance is a strict one, and the local authority is not entitled to take into account any criteria which it fails to mention in either the OJEU Notice or in the Contract documents.
- 668 The OJEU Notice should emphasise that the project is a PFI/PPP scheme and that this will mean the service provider will be expected to bear a significant proportion of the risks associated with delivery of the project. The OJEU Notice should state that variant solutions are acceptable, although where there are core mandatory requirements these should be mentioned, or referred to in the Contract documents so that bidders do not inadvertently deliver non-compliant solutions believing them to be potential variant solutions.
- 669 Local authorities are advised to bring the TUPE, pensions and workforce obligations to the attention of bidders at an early stage in the procurement process. There is a section in the OJEU Notice for 'other information', and local authorities may wish to consider making reference to the *Code of Practice on Workforce Matters in Local Authority Service Contracts*, and to use the following drafting in the OJEU Notice:
- 'The local authority will include obligations within the Contract documentation relating to workforce matters. These obligations will require the service provider to protect the terms and conditions (including pensions) of transferring staff and to employ new joiners on terms and conditions that are, overall, not less favourable than those of transferred employees and to give them reasonable pension arrangements. Service providers will be required to take account of these obligations in preparing their bid and negotiating the Contract.'*
- 670 Further guidance on workforce matters is set out in 4ps guidance.

Placing the Advert

- 671 Once drafted, Contract Notices should be sent by e-mail or submitted on-line to the Office for Official Publications of the European Union in Luxembourg for publication. There is no charge for the inclusion, and Notices will normally be published within 12 days of receipt.
- 672 If the local authority places other advertisements, for example in the specialist or trade press or the national media, these adverts must not appear before the OJEU version has been despatched, and must not contain any additional information to that contained in the OJEU Notice. Any such adverts should refer to the date of the despatch of the OJEU advertisement. It is considered good practice to send a copy of the advert to appropriate trade associations.
- 673 If the local authority is using the competitive dialogue procedure, a minimum of 37 days must be allowed from the date of despatch of the OJEU Notice to the last day that is allowed for requests to participate to be received. In the event that this 37-day period ends on a Saturday, Sunday or public holiday (in the EU), it should be extended to expire on the next working day.



674 Under certain circumstances, the minimum periods can be reduced. This must only be used when it can be fully justified on grounds of urgency and the urgency means that standard timescales are impractical. It is not considered likely that local authorities will face such circumstances in relation to the procurement of a service project.



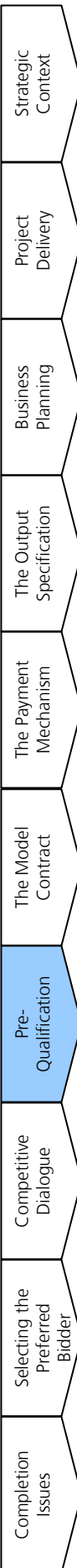
Section 3

The Descriptive Document and Bidders Conference

- 675 The number of expressions of interest which are received in response to the OJEU Notice will normally be greater than is demanded by the procurement process. However, not all those that respond will want ultimately to bid for the project. Potential bidders will base their decision about whether they want to be involved further largely on the next piece of information they receive from the local authority - the Descriptive Document (known prior to 31 January 2006 as the Information Pack). The local authority should be ready to issue the Descriptive Document and a Pre-qualification Questionnaire to everyone who responds to the OJEU Notice, ideally upon receipt of the expression of interest, but this could be at the end of the minimum period.
- 676 The Descriptive Document provides further details about the local authority and proposed project, gives a timetable for the key stages in the procurement process, and details the process to be used for pre-qualification and competitive dialogue.
- 677 It should be possible to extract much of the basic information for the Descriptive Document from the OBC and other drafts of the project documentation (such as the Output Specification). Since it is crucial to the local authority's efforts to 'sell' the project and thereby attract the best quality bidders, the Descriptive Document should be produced as informatively and attractively as possible, and be presented in a user-friendly style. A model structure of a Descriptive Document is included as part of this Procurement Pack (Model 5 –Descriptive Document). Local authorities are also advised to look at the Descriptive Documents (or Information Packs) prepared by other local authorities developing PFI and PPP projects.

Bidders Conference

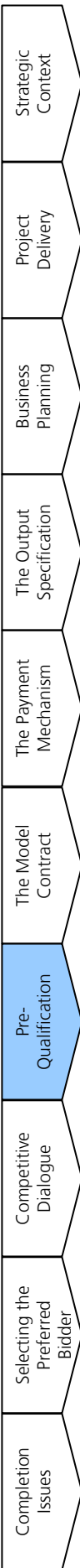
- 678 Once the Descriptive Document and Pre-Qualification Questionnaire have been issued, it may be helpful to arrange a bidders' conference which allows the local authority to provide further information to potential bidders about the scheme, and enables potential bidders to clarify issues.
- 679 With PFI and PPP now well established, potential bidders are likely to be familiar with the procurement process (particularly if they have seen this Procurement Pack). Some local authorities may, therefore, decide a bidder's conference is not appropriate, relying instead on the Descriptive Document, and on bidders seeking written clarification on any issues of uncertainty. Other local authorities have, however, held very successful bidder's conferences which have been seen by all as a useful way to expand on the project details. Approaches used for bidders conferences have included:
- Presentations by the leader of the local authority, project director, project owner, and other members of the project team, followed by a question-and-answer session
 - The use of a video presentation to outline the key aspects of the project to potential bidders rather than involving numerous speakers, followed by a question-and-answer session
 - Individual 'one-to-one' sessions with each bidder expressing an interest for a more detailed discussion of the project. This may be held either as a separate exercise, or in conjunction with formal presentations as part of a bidder's conference. If individual sessions are held with bidders, the local authority should ensure that all bidders are treated equally and are provided with the same information about the project.



- 680 Whatever approach is adopted, the key purpose is to 'sell' the project and to demonstrate to potential bidders that the local authority has the skills and expertise in place (principally in the project director and project team) to deliver the project. The bidder's conference must, therefore, be considered at an early stage in the procurement process to determine how it will fit with other arrangements, and details should be included in the OJEU Notice and the Descriptive Document.

- 681 The bidder's conference is typically held shortly after the issue of the Descriptive Document and Pre-Qualification Questionnaire (having regard to the statutory period for bidders to express an interest in the project), when potential bidders will have received all the relevant information about the project.

- 682 It is essential that the local authority treat all bidders equally during this process, ensuring that no one bidder is afforded special treatment or provided with information not available to other bidders.



Section 4 Pre-Qualification

683 As noted in Section 3 of this Part of the Procurement Pack, bidders expressing an interest in the project in response to the OJEU Notice are issued with a Pre-Qualification Questionnaire (PQQ) at the same time as the Descriptive Document. The aim of the PQQ is to:

- Obtain information that will establish whether potential bidders, or bidding consortia, have the technical and professional ability, and have the economic and financial standing to deliver the project. PFI/PPP contracts are complex and expensive to deliver, and local authorities must ensure that only those bidders, or bidding consortia, with the appropriate resources and skills-base are pre-qualified
- Enable the local authority to determine whether there are any grounds pursuant to which a bidder may be rejected under the Procurement Regulations.

The Pre-Qualification Questionnaire (PQQ)

684 The PQQ should set out questions that each bidder will be required to answer. The extent of the information that can be requested from each bidder at this stage, however, is limited by the Procurement Regulations to information for proving economic and financial standing, and technical and professional ability. The information that can be sought as part of the pre-qualification is set out in the Public Contracts Regulations 2006, which also set out the grounds on which candidates may be automatically excluded.

Information for proving Economic and Financial Standing

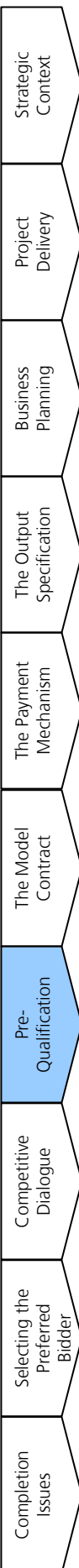
685 The Public Contracts Regulations 2006 set out the information that a local authority may request from a bidder to prove economic and financial standing. This includes:

- A statement of accounts relating to the bidder's business, or extracts from such accounts
- A statement of the turnover of the firm's business as a whole, in the firm's previous three financial years
- A statement of the bidder's turnover in its previous three financial years in respect of the works or type of service proposed under the Contract
- Appropriate statements from the bidder's bankers, or evidence of relevant professional risk indemnity insurance.

686 Whilst 'economic and financial standing' is not expressly defined, it is clear that the Public Contracts Regulations 2006 only authorise measures genuinely directed at assessing economic and financial standing in relation to the relevant contracts.

Information for proving Technical and Professional Ability

687 The Public Contracts Regulations 2006 set out the nature of the information that can be requested in relation to technical and professional ability. The information that may be requested includes the following:



- The bidder’s educational and professional qualifications; and the qualifications of bidders managerial staff and the person(s) responsible for providing the services
- A statement of the principal services provided by the bidder in the past three years, which are of ‘a similar type’ to the services to be provided under the Contract, along with appropriate verifying details
- A statement of the bidder’s technical facilities, measures for ensuring quality control, and details of the bidder’s study and research facilities
- A statement of the bidder’s average annual number of employees and the number of managerial staff employed over the previous three years
- A statement of any proportion of the Contract that the bidder intends to sub-contract to another.

688 There is provision for actual checks in certain cases on the bidder in relation to the services to be provided, study and research facilities, and quality control measures.

689 ‘Technical and professional ability’ are not defined in the Public Contracts Regulations 2006. Local authorities must take care, and legal advice should be sought, on whether it is acceptable to include provisions relating to health, safety, equal opportunities and environmental protection in the PQQ.

Other Issues

690 Local authorities can, in accordance with normal business practice, ask bidders to provide details of referees for relevant projects that they have undertaken, either as part of the PQQ, or later as part of competitive dialogue. At whatever stage referees are contacted, the information sought, and the use made of that information, must be consistent with what is allowed under the Procurement Regulations.

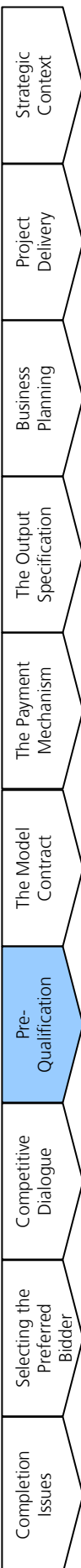
691 In the case of a bidding consortium, the PQQ should aim to obtain the information required from each member of the proposed consortium. The onus should be on the bidder to demonstrate that it has the resources to see the bid through to completion. Caution should be exercised where a bidder intends to tender aspects of the service project to as yet unidentified third parties. In such circumstances, bidders should be asked to demonstrate that they would be able to recruit the necessary additional companies within the framework of the deal that is envisaged prior to the selection of Preferred Bidder.

692 The time allowed for the bidders to respond to the PQQ will vary with the amount of information requested. A period of six weeks will normally be long enough for Bidders to collate their pre-qualification responses.

693 A model PQQ for a PFI/PPP project in the sector is included in this Procurement Pack (Model 6 – Pre-Qualification Questionnaire). Given the confines that govern the pre-qualification stage, it is important that local authorities take their own legal advice on the development of the PQQ for the project.

Evaluation of Pre-Qualification Responses

694 The tests and criteria that will be used to evaluate the PQQ responses should be identified in advance, and legal advice taken on developing the framework. A local authority has considerable discretion to determine the precise details of how it conducts the pre-qualification evaluation, and appears to be given the right to set minimum standards of financial and economic standing and technical and professional ability.



695 Whilst acknowledging that pre-qualification is principally a 'pass/fail' test, the local authority may decide to use a detailed scoring system, possibly with different weightings being given to different factors.

696 Where local authorities receive PQQ responses indicating different levels of consortium membership, care should be taken to treat all consortia on an equal basis during the pre-qualification evaluation.

697 A model evaluation methodology for pre-qualification is included in this Procurement Pack (Model 7 – PQQ Evaluation Framework). This evaluation framework follows the structure of the model PQQ included in this Procurement Pack.

698 The key stages involved in a typical pre-qualification evaluation are as follows:

Stage One – Preliminary Evaluation and Compliance

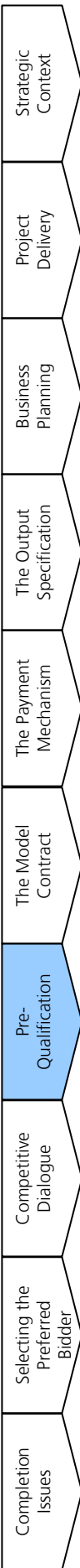
699 A preliminary evaluation should be carried out to de-select any bidder that would clearly fail to satisfy any criterion. Factors to consider include:

- Information requirements – has the bidder supplied all of the information requested for pre-qualification (in cases where the submission is unclear the local authority may ask for more information for clarification; such requests must be very specific and kept to a minimum)
- Preliminary financial evaluation – to assess whether the bidder (or bidding consortium) meets the minimum financial thresholds (such as turnover level relative to a multiplier of the scheme's estimated capital or services value).
- Eligibility - to assess whether there is reason for excluding any bidder or bidding consortium from further analysis (see below)

700 The circumstances in which a bidder may be excluded from further participation in the procurement process include the following:

- Bankruptcy, insolvency and winding-up - the circumstances of such are defined in the Procurement Regulations
- Where the bidder has been convicted of a criminal offence relating to the conduct of its business or profession
- Where the bidder has committed an act of grave misconduct during the course of its business or profession
- Where the bidder has not fulfilled obligations relating to the payment of taxes or social security contributions
- Where the bidder is guilty of serious misrepresentation in providing any information required of it under the Public Contracts Regulations 2006
- Where the bidder is not properly licensed under the laws of the state in which it is established

701 Bidders should be asked to confirm in their response to the PQQ that none of the grounds for exclusion set out in the Procurement Regulations applies to any member of the bidding consortium. Bidders should also be required to inform the local authority during the procurement process if any of these grounds apply subsequently.



702 The purpose of the preliminary evaluation is to assess whether the bidder has the ability to undertake the project. The financial thresholds are partly designed to ensure that the project does not overly dominate the relevant companies' existing business. The local authority should only exclude bidders who are not considered to have a realistic chance of undertaking the project.

703 A credible bidder who does not have the skills to undertake the whole Contract may submit a PQQ for a consortium of as yet unidentified members who would provide the relevant skills. Provided it was made clear to all bidders that a pre-qualified submission could be made on this basis, assessment should be made as to whether the bidder is a leading player in its field, and whether, in the opinion of the project team, it has demonstrated it could attract other parties to form a consortium capable of undertaking the project.

Stage Two – Technical and Professional Ability

704 The submissions which are considered compliant and which have met the preliminary evaluation criteria should be evaluated to determine technical and professional ability on a qualitative basis. If the bidder is deemed to have only marginally passed the preliminary stage, the local authority may decide to take them to the next stage of determining their technical and professional ability. Scores will be assigned to the responses to each of the questions, which are likely to be weighted. The local authority will need to determine a pass score for the technical evaluation.

705 Further details on the evaluation of technical and professional ability are provided in the model documentation for the evaluation of PQQ responses.

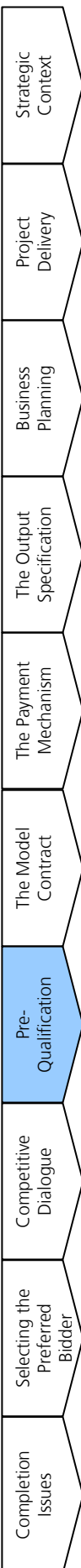
Stage Three – Economic and Financial Standing

706 The financial evaluation for each bidder, and each member of a bidding consortium, can be assessed in two ways:

- Solvency and financial strength should be assessed through analysis of the bidder's and consortium members' financial accounts and other information requested as part of the PQQ. Text-line information (search of newspaper, trade press and other databases for the last six months) and credit ratings (such as Dunn and Bradstreet) should also be used as part of this evaluation.
- Fund-raising experience and ability should be assessed by reference to the number of times the relevant bidder or consortium member has raised finance for similar projects, considering both equity and debt forms of capital and the amounts raised for these projects. The ability to raise and/or contribute equity capital should be considered with respect to the relevant companies' net worth and the cash resources. Other information to consider includes the financing structure the bidder envisages for the project and how bidding costs of the project are to be borne and financed.

Constructionline

707 Constructionline is the UK's register of local and national pre-qualified construction and construction-related services. Owned by the Department of Trade and Industry, it is supported by DCLG and OGC. The Model Pre-Qualification Questionnaire included in this Procurement Pack contains questions on company finances, insurances, quality assurance accreditation, health and safety and equal opportunities. Much of this information is held by Constructionline for each of the contractors and consultants registered on its database.



708 In order to avoid duplication, the 4ps Model Pre-Qualification document has been annotated to show clearly which questions have already been asked by Constructionline of its registered companies, and which documents are held. Local authorities that use Constructionline could therefore avoid duplication in requesting information.

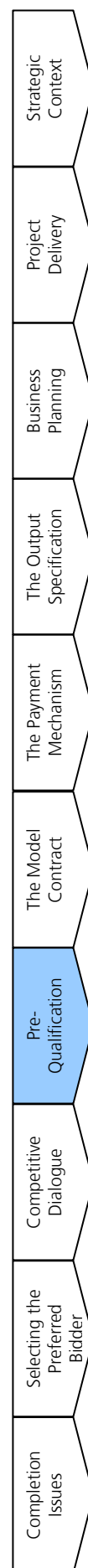
Pre-Qualification Report

709 The PQQ evaluation will enable a list of 'pre-qualified bidders' to be made on the basis of technical and professional ability, and economic and financial standing. A report setting out the results and conclusions of the evaluation should be produced to provide a clear audit trail for the process and of the reasoning behind the assessment of pre-qualified bidders.

710 To maintain the integrity of the process, once these pre-qualification tests have been passed they should not be re-visited. The local authority should not need to re-evaluate competence unless new information emerges which gives reason to doubt the original assessment, or if a member of the bidding team changes.

De-briefing of unsuccessful candidates

711 Bidders that do not satisfy the pre-qualification criteria should be informed as soon as possible. Example documentation for this is included in this Procurement Pack (Model 8 – Pre-Qualification Correspondence). Such bidders should also be offered the opportunity for a de-briefing on where their PQQ was judged to be deficient. Within 15 days of a written request from an unsuccessful bidder to do so, the local authority must inform the bidder of the reasons why it was unsuccessful. This can be done either in writing or as part of a formal discussion with the bidder.



**STREET LIGHTING
PROCUREMENT PACK
PART EIGHT
COMPETITIVE DIALOGUE**

Strategic
Context

Project
Delivery

Business
Planning

The Output
Specification

The Payment
Mechanism

The Model
Contract

Pre-
Qualification

Competitive
Dialogue

Selecting the
Preferred
Bidder

Completion
Issues

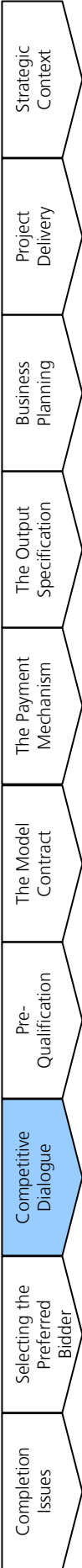
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Section 3 Detailed Solutions	159
Section 4 Refinement of Solutions	162
Section 5 Closing Competitive Dialogue and Seeking Final Tenders	163

Also relevant to this Part Eight of the guidance is:

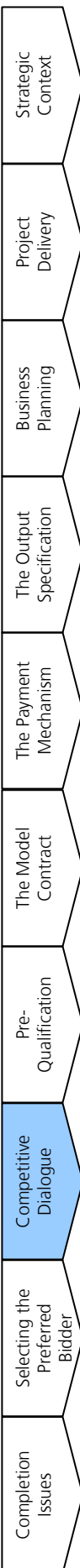
- **Model 9 – Invitation to Submit Outline Solutions**
- **Model 10 – Short-Listing Correspondence**
- **Model 11 – Invitation to Submit Detailed Solutions – Instructions and Guidance**
- **Model 12 – Invitation to Submit Refined Solutions**

- **Worksheet 6 – Evaluation of Outline Solutions**
- **Worksheet 7 – ISDS Financial Proforma**
- **Worksheet 8 – Evaluation of Detailed Solutions**



Section 1 The Competitive Dialogue Process

- 712 The competitive dialogue is a new procedure introduced by Article 29 of Directive 2004/18/EC for use in the procurement of 'particularly complex projects', where the OJEU Notice is despatched on or after 31 January 2006. Competitive dialogue has been effective in the UK since 31 January 2006; the date of implementation of the Directive, by way of The Public Contracts Regulations 2006 into UK law.
- 713 Competitive dialogue is described in the Directive as follows:
- "A procedure in which any economic operator may request to participate and whereby the contracting authority conducts a dialogue with the candidates admitted to that procedure, with the aim of developing one or more suitable alternatives capable of meeting its requirements and on the basis of which the candidates chosen are invited to tender".*
- 714 Although competitive dialogue is more structured and regulated than the negotiated procedure, there are nevertheless many similarities. Like the negotiated procedure, the procedure begins with an OJEU notice and pre-qualification stage. Bidders selected following the pre-qualification stage are then invited to participate in a dialogue.
- 715 The dialogue phase enables the local authority to have discussions with bidders with the aim of identifying and defining the means best suited to meet the local authority's needs. The dialogue may take place in successive stages to reduce the number of solutions discussed and bidders involved. A solution need not be just a technical solution, but can also be a solution which covers the entirety of the local authority's requirements, including pricing. Once the required solution or solutions have been identified, the local authority declares the dialogue to be closed. This Procurement Pack assumes that the following stages of dialogue will be used:
- Initially on bidder's outline solutions
 - On bidder's detailed solutions, which will include pricing and the entirety of the solutions offered
 - Possibly on refined solutions following dialogue on the detailed solutions, before final tenders are sought.
- 716 Those bidders remaining at the conclusion of the dialogue are then invited to submit final tenders based on the solution(s) identified. Final tenders can be 'clarified, specified and fine tuned' provided that this does not involve changes to the basic features of the tender.
- 717 Once a Preferred Bidder has been identified (i.e. the bidder providing the most economically advantageous tender), there is a further opportunity to 'clarify aspects of the tender or confirm commitments' provided, again, that there are no substantial changes to the tender and that this does not risk distorting competition or causing discrimination.

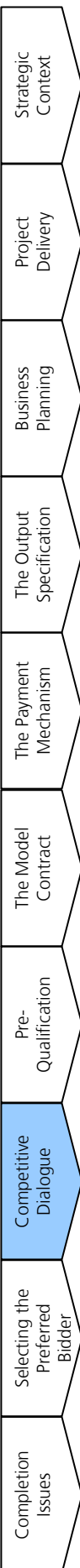


Section 2 Opening Competitive Dialogue and Seeking Outline Solutions

- 718 Once a list of pre-qualified bidders has been approved, the competitive dialogue process can be formally opened. Bidders are sent an Invitation to Submit Outline Solutions (ISOS) requesting more detailed information on their proposed approach to the structure and delivery of the project, and their willingness or appetite for taking on the risks entailed. Receipt of the bidder's outline solutions will enable the local authority to evaluate bidder's initial solutions, and to initiate dialogue with relevant bidders on their proposed solutions. The aim of this initial competitive dialogue is to arrive at a short-list of bidders with whom to enter in to further competitive dialogue on detailed solutions.
- 719 Whereas pre-qualification is a test of financial standing and technical and professional ability to undertake the proposed project, the first stage of competitive dialogue and evaluation of bidder's outline solutions to determine a short-list of bidders must be on the grounds of ability and commitment to offer a viable solution for the project. How many bidders are short-listed to go through to the next stage of competitive dialogue will depend on the local authority's criteria. However, because of the time, money and physical resources required to work-up detailed solutions for a PFI or PPP project, a pragmatic approach is recommended to ensure that the short-list is limited to the minimum number of bidders needed to ensure genuine competition. The local authority will probably only wish to deal with three or four bidders at the next stage of the process when it invites bidders to submit detailed solutions for the project.
- 720 The Procurement Regulations governing competitive dialogue do not expressly specify how the local authority should undertake the various stages of competitive dialogue. There is clearly a need to proceed with caution and local authorities must be careful to maintain a level playing field and avoid any suggestion of discrimination or lack of transparency.
- 721 For clarification, 4ps does not advocate the use of a PQQ on its own to arrive at a short-list of bidders. Pre-qualification principally assesses a bidder's past performance, and the scope of pre-qualification is limited to those aspects set out in the Procurement Regulations. Initiating competitive dialogue, and evaluating outline solutions from bidders enables the local authority to seek information specific to their PFI/PPP project, and to determine which bidders are best placed to the next stage of competitive dialogue.

The Invitation to Submit Outline Solutions (ISOS)

- 722 A model ISOS has been developed as part of this Procurement Pack (Model 9 – Invitation to Submit Outline Solutions). The model comprises a series of questions from which local authorities can identify those appropriate to their own circumstances and competitive dialogue process. The number of questions selected for the ISOS should be kept to a sensible number, and should be aimed at differentiating bidders' solutions, rather than eliciting standard responses.
- 723 It may be appropriate at this stage of competitive dialogue to ask bidders where, within a broad range, they expect their pricing to be (an indicative pricing, without commitment). Local authorities need to consider the inclusion of such a question at this stage in the context of their comfort with the Reference Project developed as part of the OBC.



Evaluation of ISOS Responses

- 724 A framework for evaluating ISOS responses, including the weighting that will apply to each of the ISOS questions, should be in place prior to launch of competitive dialogue. Details of the ISOS evaluation criteria should be disclosed to bidders (it is suggested a summary is included in the ISOS). The criteria for selection of the short-list must be consistent with the award criteria specified at the outset.
- 725 This Procurement Pack includes a template ISOS evaluation framework for the evaluation of ISOS responses (Worksheet 10 - ISOS Evaluation) from which local authorities can develop their own version. More detailed worksheets are likely to be necessary to support the evaluation of each of the ISOS questions. This may include a series of key attributes that the local authority expects the bidder to address as part of the ISOS response, or a series of further detailed evaluation criteria and weightings for each ISOS question.

Dialogue and Interviews

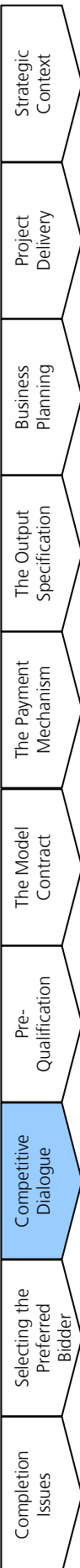
- 726 As part of this initial stage of competitive dialogue, the local authority should enter in to competitive dialogue with the bidders, potentially both during the outline solutions' preparation period, and then following the evaluation of bidder's ISOS responses. Care needs to be taken to ensure that all bidders are afforded the same opportunities. Interviews can be a useful way of seeking clarification on key aspects of the bidders' solutions at the ISOS stage, and as a final way of differentiating between bidders in order to arrive at the short-list of bidders for subsequent dialogue.

Three or Four Bidders

- 727 The short-list should be limited to the minimum number of bidders needed to ensure genuine competition and required under the Procurement Regulations. In general this should be three, or at the most, four bidders.
- 728 Opinions vary on the optimum number of bidders to be short-listed. Some local authorities and advisors believe that the advantage of short-listing three bidders is the likelihood of better quality bids at the ISDS stage, since bidders will determine that they have a better chance of proceeding from a one-in-three position than a one-in-four. Some, however, have been reluctant to select only three bidders because if one drops out, competition is restricted to only two bidders. Yet another view is that there is a greater chance of losing one of four bidders.
- 729 Aps view is that three bidder's is optimum for detailed competitive dialogue, with four taken forward only in exceptional circumstances. However, ultimately this is a matter for local discretion and local authorities must take their own advice on this issue. Such decisions must also be determined in the context of the local authority's Standing Orders.

Report and Debriefing

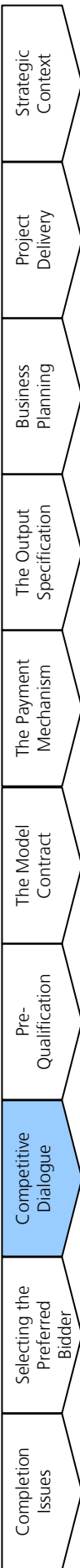
- 730 A report should be produced summarising the conclusions of the initial competitive dialogue or short-listing process, and providing a clear audit trail of the process adopted and short-list selected. In compiling the report, the integrity of the short-listing process must be safeguarded, and there should be no leakage of ideas from one bidder's commercial solutions to another.



- 731 It is likely that the results of the initial competitive dialogue and short-listing evaluation, and the accompanying report, will need to be agreed with the strategic project board (and the stakeholder board where relevant), and this must be done before proceeding to subsequent stages of competitive dialogue.

- 732 Arrangements should have been incorporated into the project timetable for agreeing the short-list with the staff representatives, which ideally should be done before the short-list is finalised. Some local authorities have used the consultation at this stage in the process to discuss with the staff representatives the comments made by the bidders as part of their ISOS response on staffing issues.

- 733 Bidders not taken forward to the ISDS stage should be informed as soon as possible. Example documentation for this is included in this Procurement Pack (Model 10 – Short-Listing Documentation). Bidders should also be offered the opportunity for a de-briefing on where their outline solutions were judged to be deficient (this may be by telephone or with a meeting). Within 15 days of a written request from an unsuccessful bidder to do so, the local authority must inform that bidder of the reasons why it was unsuccessful. This can be done either in writing or as part of a formal discussion with the bidder.

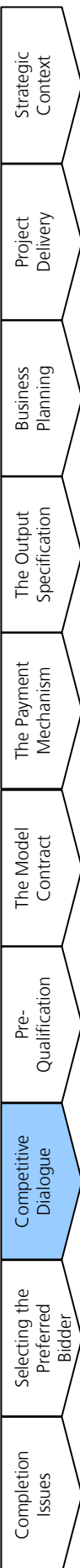


Section 3 Detailed Solutions

- 734 Once the short-list of bidders has been selected and approved, the local authority can issue the ISDS to the short-listed bidders.
- 735 The ISDS should have been substantially ready to be issued prior to the local authority opening competitive dialogue, and ideally at the time of issue of the OJEU Notice. It is often helpful, however, to have a short period (say four weeks) between the selection of the short-list and issue of the ISDS to allow the local authority to incorporate any issues identified as part of the pre-qualification and initial competitive dialogue process (within the confines of the Procurement Regulations).
- 736 Having such a period will also give the local authority time to meet with each of the short-listed bidders to outline the next stages of the process. Any major issues of concern to the bidders (such as the timetable for the next stage of competitive dialogue) can also be incorporated into the ISDS documentation before it is issued.
- 737 If any major issues have come to light as part of the pre-qualification and initial competitive dialogue process, the local authority may need to revisit some of the original assumptions included in the OBC and/or Reference Project. If necessary, the scope, affordability and funding arrangements for the project should be re-affirmed. This must be done before the ISDS is issued.

The Invitation to Submit Detailed Solutions

- 738 The ISDS should in most cases be a development of the Descriptive Document, but provide more detail in terms of:
- Instructions and guidance to the short-listed bidders on the process to be followed for the next stage of competitive dialogue, the timetable, the local authority's requirements for detailed solutions, and the criteria for evaluation of detailed solutions
 - The services required (as set out in the Output Specification)
 - The proposed contractual terms governing the arrangement, including any preferred Contract length and Payment Mechanism
 - The extent to which bidders are able to submit variant solutions, or any constraints on variant solutions.
- 739 It is important that the ISDS is fully developed before it is issued. Local authorities cannot expect to undertake meaningful competitive dialogue, and for bidders to respond adequately with fully-thought-through solutions, if the documentation explaining what that entails is incomplete.
- 740 This Procurement Pack has been developed on the assumption that the ISDS will be developed as two 'volumes':
- Volume One –Instructions and Guidance to Bidders
 - Volume Two – the Model Contract, incorporating the Output Specification and Payment Mechanism.



741 **Volume One** – the Instructions and Guidance to Bidders (the ‘Instructions’), should set out what the local authority’s requires from bidders, the process for competitive dialogue, the process to be followed in the bidding process, and how the bidder’s solutions will be evaluated. This Procurement Pack includes model documentation for the Instructions (Model 11 – ISDS – Instructions and Guidance to Bidders and Worksheet 7 – ISDS Financial Proforma). Local authorities are advised to use these as a basis for developing appropriate Instructions for the ISDS stage. The appropriateness of the service delivery and technical requirements included in the model Instructions need to be assessed to ensure that they provide the relevant information for the approach being used in the Output Specification.

742 **Volume Two** – the Model Contract should set out all the proposed terms of the agreement between the local authority and the service provider for the project. Guidance on developing the Output Specification, Payment Mechanism and Model Contract is included in Parts Four to Six of this Procurement Pack respectively.

743 Local authorities have typically found it useful to require bidders to submit a ‘Standard Solution’ to assist with competitive dialogue and the evaluation process, and to give a common starting point for any subsequent fine-tuning and clarification. However, the use of a standard bid should not indicate that the local authority has a preferred option; innovation and variant solutions should be encouraged. The standard solution should be standard only as regards a Model Contract setting out a proposed allocation of risks; there should not be a standard requirement for delivery of the service (albeit within an overriding requirement as regards compliance with the sector-specific Model Contract drafting on *Standardisation of PFI Contracts* issues).

Bid Preparation Period

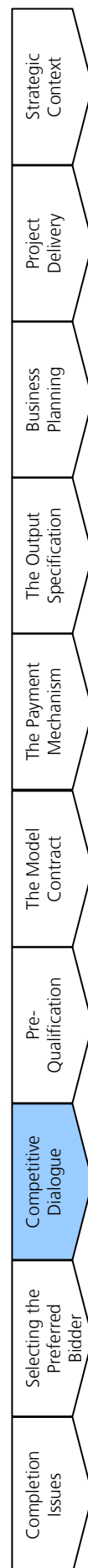
744 Competitive dialogue with bidders during the preparation period for detailed solutions will allow the local authority to explain some of the background thinking behind the ISDS documentation, and allow bidders to explore innovative solutions to meeting the Output Specification. These discussions should be confidential to each bidder, unless they result in any modification to the definition of service requirements, in which case such changes should be notified to all bidders.

745 Following a brief period to assimilate the documentation, bidders should be invited to raise any points of principle. Dialogue should then be initiated with each bidder to discuss emerging issues and clarification points prior to the submission of detailed solutions. Constructive dialogue with each bidder will lead to better and more complete solutions, and significantly reduces the time taken to fine-tune and finalise the deal.

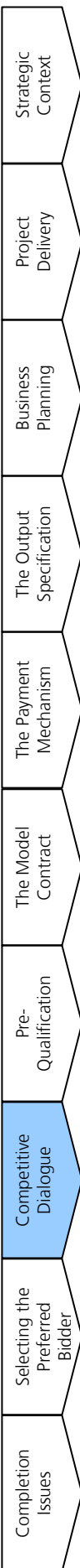
746 The Model Instructions and Guidance to Bidders included in this Procurement Pack includes proposed drafting on how to initiate competitive dialogue during a bid preparation period, and the procedures for dealing with bidders’ queries, and any necessary amendments to the ISDS documentation.

Evaluation of Bids

747 The evaluation framework which must be in place to evaluate bidders’ responses to the ISDS should be capable of dealing with both the standard bid and with any variant bid submissions. The ISDS instructions and guidance to bidders should include an indication of the overall structure of the evaluation framework and an indication of the weighting to be applied to each category. An example of such an approach is included in the Model 11 – ISDS – Instructions and Guidance to Bidders included in this Procurement Pack.

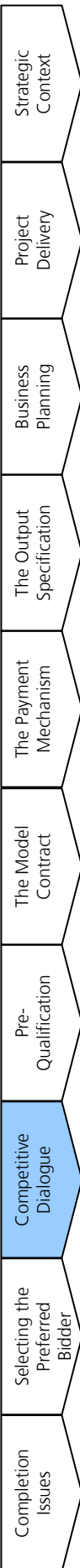


- 748 The criteria on which the local authority intends to base its choice of service provider will have been stated in the OJEU Notice.
- 749 The information included in the bidders' responses to the ISDS are likely to amount to many volumes of data and the evaluation of bidders' detailed solutions will be a formidable task. The overall aim of the evaluation process is to select the solution that is the most economically advantageous to the local authority, having regard to the overall aims and objectives of the project.
- 750 The first stage of the evaluation process should be to check bids for compliance with the Instructions and Guidance to Bidders, and for completeness. Bids that are not substantially complete, or which are non-compliant may be rejected. The local authority should enter into further competitive dialogue, and reserve the right to call for more information in clarification of solutions, or to assist in the assessment and evaluation of solutions.
- 751 Evaluation of solutions will typically involve the project team and other stakeholders working in smaller teams and focusing on, for instance, 'service delivery and technical', 'financial and commercial', and 'legal and contractual'. Each 'team' should be responsible for producing an evaluation report.
- 752 An overall summary evaluation model should be developed that sets out the results of the evaluation of the standard and variant solutions (see Worksheet 8 of this Procurement Pack). Such a model should be supported by detailed marking schedules, with appropriate weightings, setting out the specific requirements expected under each component of the evaluation framework. The evaluation framework must be capable of dealing with local circumstances and the local authority's detailed requirements. In developing the evaluation framework for the technical aspects, it is important that the local authority includes appropriate allowance for innovation in bidders' solutions to deliver the Output Specification.
- 753 Local Authorities should not underestimate the amount of time required for this evaluation stage. Time should be allowed for further competitive dialogue with the bidders to clarify and fine-tune issues in order to fully evaluate the solutions being made, particularly where variant solutions have been submitted. It may be appropriate for each bidder to present their solutions formally, and local authorities may also wish to undertake site visits as part of the evaluation process.



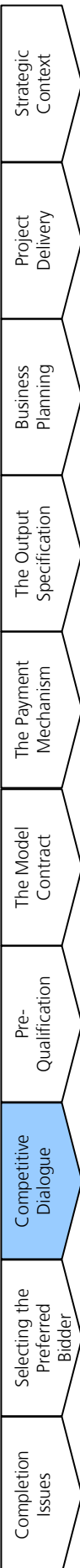
Section 4 Refinement of Solutions

- 754 At the end of the ISDS evaluation process, the local authority may determine that it is appropriate to de-select one or more of the bidders; enter in to further competitive dialogue with bidders; formally seek refined solutions (such as through the issue of an Invitation to Submit Refined Solutions or ISRS) from all bidders or a revised short-list of bidders; or close competitive dialogue and seek a 'Final Tender' from all or selected bidders.
- 755 Model documentation for the Instructions to Bidders where an ISRS is to be sought is included as Model 12 of this Procurement Pack. Guidance on closing competitive dialogue and seeking Final Tenders is dealt with in Section 5 of this Part of the Procurement Pack.
- 756 Whichever option is chosen, the conclusions of the evaluation should be fully documented in an ISDS Evaluation Report, and the decision on how to proceed further reported to, and agreed with, the strategic project board.
- 757 Bidders that are not to be taken forward should be informed as soon as possible and be offered the opportunity for a de-briefing on where their ISDS proposals were judged to be deficient.



Section 5 Closing Competitive Dialogue and Seeking Final Tenders

- 758 Once the local authority is satisfied that the competitive dialogue process is ready to be closed, it will be necessary to formally request 'Final Tenders' from the remaining bidders.
- 759 Local authorities are advised to read Part Nine of this Procurement Pack to understand the issues that need to be completed before the selection of a Preferred Bidder as this will help inform the timing of when to close competitive dialogue and seek final tenders. In summary, in advance of seeking Final Tenders from the remaining bidders, the following aspects should have been resolved through competitive dialogue (or the local authority is confident that the issues will be completed as part of the Final Tender process):
- Bidder's have confirmed their acceptance to the key contractual terms
 - Bidder's have confirmed that they have access to finance that does not require underwriting by the local authority
 - Bidder's have presented solutions that meet the requirements of the Output Specification
 - Bidder's are expected to quote (as part of their Final Tender) a price that is affordable to the local authority
 - Bidder's are expected to put forward as part of their Final Tender a whole-life solution that demonstrates Best Value
 - If a consortium, the bidder has shown that it is a cohesive entity rather than a disparate collection of organisations
 - The bidder has (where relevant) submitted a solution that is able to satisfy the PFI criteria requirements, in particular it is able to satisfy the off balance sheet test under FRS5.
- 760 Once competitive dialogue is closed, only limited fine tuning of the final tenders is allowable, and once a Preferred Bidder has been selected the local authority is only able to 'confirm commitments' and clarify aspects of the tender'. It is important therefore that the local authority considers carefully when to close competitive dialogue.



**STREET LIGHTING
PROCUREMENT PACK
PART NINE
SELECTING THE PREFERRED
BIDDER**

Strategic
Context

Project
Delivery

Business
Planning

The Output
Specification

The Payment
Mechanism

The Model
Contract

Pre-
Qualification

Competitive
Dialogue

Selecting the
Preferred
Bidder

Completion
Issues

Contents – Part 9 – Selecting a Preferred Bidder

Section 1
Selection of a Preferred Bidder

Section 2
Reserve Bidders

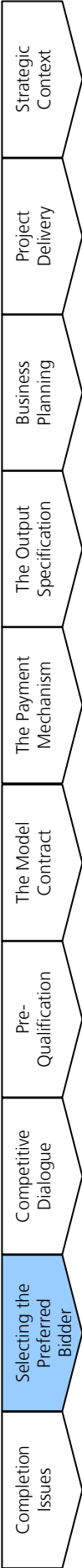
Also relevant to this Part Nine of the guidance is:

- **Model 13 – Preferred Bidder Letter**

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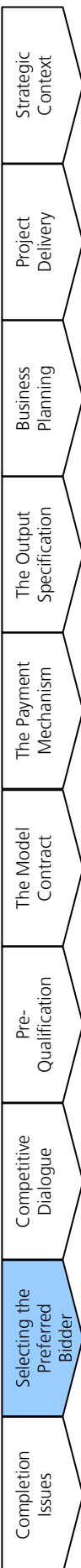


Section 1 Selection of Preferred Bidder

- 761 The selection of a Preferred Bidder signals the end of the competitive process for the procurement of the project, and is the final stage before financial close. Since competition is the paramount driver of value for money, great care needs to be taken to ensure that the appointment of a Preferred Bidder is not made prematurely thereby precluding other options. On the other hand, prolonging competition beyond a point that is optimal merely racks up costs for both the local authority and bidders, and reduces the appetite of bidders for participation in future projects.
- 762 The period between selecting a Preferred Bidder and financial close is intended to be used to clarify and confirm certain details rather than to have substantive negotiation over the essential Contract terms – for example, to work on the detailed drafting of certain provisions, finalising and drafting the non-controversial schedules to the Contract, and putting the financial documentation in place.
- 763 The final discussions should be limited to fixing the final detail of the transaction documentation and satisfying the reasonable requirements of the service provider’s board and funders. Since it is highly undesirable to reopen commercial terms at this late stage, the risk of this should be minimised by insisting that the Preferred Bidder’s funders have indicated their comfort with the risk allocation embodied in their solution at a stage where there is still the lever of competition – i.e. during competitive dialogue. The local authority’s financial advisors should contribute to this process by advising whether the Preferred Bidder’s proposals are realistic, and the levels of financial commitment are appropriate.
- 764 Anything more, particularly where it involves a major reallocation of the risk transfer previously agreed, or a radical reassessment of the price at which the bids were placed (either detailed solutions or refined solutions), or the introduction of funding institutions without prior involvement hitherto, would usually be indicative of a Preferred Bidder being announced prematurely.

Key Criteria for Selecting a Preferred Bidder

- 765 Delays following the selection of a Preferred Bidder tend to result from earlier acts or omissions. If the indicative time-scales shown in Figure 7.1.1 of this Procurement Pack are to be achieved, a number of key criteria should have been met prior to the selection of Preferred Bidder. These include the potential Preferred Bidder having:
- Accepted the key contractual terms
 - Confirmed access to finance that does not require underwriting by the local authority
 - Presented a solution that meet the requirements of the Output Specification
 - Quoted a price that is affordable to the local authority
 - Put forward a whole-life solution that demonstrates Best Value
 - If a consortium, shown that the service provider is a cohesive entity rather than a disparate collection of organisations
 - Where relevant, submitted a solution that satisfies the PFI criteria, in particular, the off balance sheet test under FRS5
 - Accepted the project delivery milestones.



766 If these criteria are satisfied, the local authority should de-select the other remaining bidders and (if appropriate) establish a Reserve Bidder.

Acceptance of Key Contractual Terms

767 Whilst some elements of the Contract will always remain to be clarified and confirmed between the appointment of the Preferred Bidder and financial close, it is recommended that the key commercial terms in the contractual documentation (including the Output Specification and Payment Mechanism) be fully agreed with the Preferred Bidder before appointment. This should include confirmation from the debt providers that the contractual terms are acceptable.

768 The local authority's assessment and evaluation of the bids must be robust to ensure that:

- The financing packages proposed by the Preferred Bidder are deliverable
- The Preferred Bidder has involved the debt and equity providers in a review of the contractual terms and proposed risk allocations, and they have accepted them
- The debt providers have undertaken adequate due diligence of the contractual documentation and that this is evidenced in the solution submitted by the Preferred Bidder.

769 Under the negotiated procedure, failure to tie down contractual documentation in a realistic manner at a sufficiently early stage in the procurement process caused difficulties for local authorities having to engage in drawn-out periods of negotiating with a Preferred Bidder.

770 If a local authority is intending to seek derogations on *Standardisation of PFI Contracts* issues from the relevant sponsoring department and HM Treasury-approved position as set out in the sector-specific contract, it is suggested that the local authority agree these with relevant department prior to selection of Preferred Bidder (and before Final Tenders are sought).

Confirmed access to finance

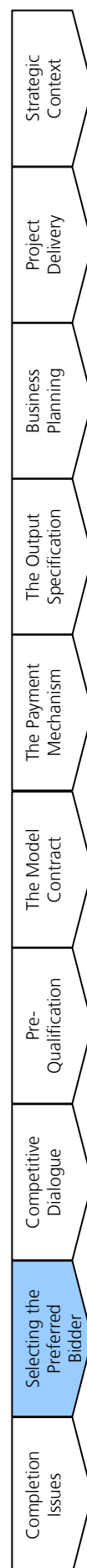
771 A solution cannot be credible without satisfactory assurances of the adequacy of funding. As part of the evaluation of detailed solutions, the local authority should have received assurances from the funding institutions behind the proposed Preferred Bidder that they are willing to finance the proposed project.

772 As part of the local authority's assessment and evaluation of bids, as much information as possible should be sought on:

- The 'quality' of the funding institutions
- The financing plan and the preliminary term sheet for the financing facilities to deliver that plan
- The security funders are likely to seek
- Funders experience of financing PFI/PPP projects
- The proposed method of funding.

773 Bidders' term sheets for the facilities required as part of the financing plan should be required as part of a bidders' detailed solution. The deliverability of the financing plan should be an explicit part of the criteria for evaluating bidder's solutions, and a matter on which the local authority should seek the advice of their financial advisors in order to test the proposals received.

774 Before the appointment of a Preferred Bidder, the local authority should require confirmation from the debt providers that:



- The debt providers have reviewed the results of the financial model runs reflecting the results of the commercial proposals agreed between the local authority and the bidder as a basis of the bidder's selection as Preferred Bidder, and are satisfied, subject only to final credit approval, that those results are capable of supporting the debt facilities envisaged by the project's financing plan
- All key aspects of the debt providers' due diligence process that could affect their willingness to enter into the financing have been completed to the debt providers' satisfaction. It will be necessary to identify which aspects of the due diligence process have this degree of significance. To sign off certain issues, debt providers may need to engage specialist consultants. In deciding how far the due diligence process should have been completed before a Preferred Bidder is selected, the local authority will need to pay attention to the cost of the due diligence process
- The debt providers have reviewed and signed off the Model Contract, and/or have put forward proposed changes as part of a variant solution
- Debt providers have been asked to confirm, subject to any outstanding aspects of their due diligence programme, that they have received 'in principle' approval from their credit committees or other internal sanctioning authorities to enter into the financing on the basis contemplated by the financing plan
- A timetable to financial close has been submitted, and agreed with the debt providers. Confirmation should also be sought from the debt providers of the extent of their due diligence programme still remaining to be completed.

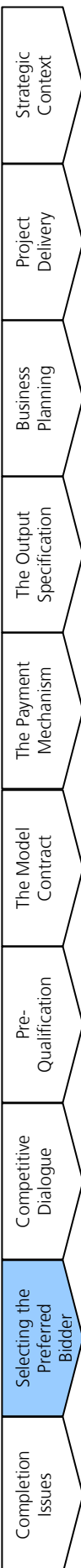
775 The local authority should not require all debt providers' due diligence checks to have been completed prior to the selection of a Preferred Bidder. In most cases, it will be more cost effective if parts of the due diligence work is carried out after the selection of Preferred Bidder. Bidders are understandably reluctant to commit to the expense of full debt providers' due diligence until they enjoy the security of Preferred Bidder status, and the local authority should not expose bidders to unnecessary expense before this point.

776 The local authority should include in the ISDS Instructions and Guidance to Bidders a statement of its requirements for completion of debt providers' due diligence prior to selection of a Preferred Bidder. If refined solutions are sought as part of the competitive dialogue process, this statement should be repeated in the ISRS. This will enable the process to be discussed and agreed with bidders, and their debt providers, during the competitive dialogue period.

Solution meets the Output Specification

777 Bidders are likely to have put forward a variety of solutions to meet the requirements for the project set out in the Output Specification. Before selecting a Preferred Bidder, the local authority must judge which solution offers the most innovative and cost-effective option to meet the requirements of the Output Specification, without the service either being gold-plated at the one extreme, or falling below acceptable standards at the other.

778 If it appears likely that, despite there being a leading bidder, another bidder has the scope for refining its solutions to match more closely the local authority's requirements, then the opportunity should be given at the competitive dialogue stage to all bidders to improve on their earlier solutions within a certain timescale. It clearly benefits the local authority to take advantage of the existence of competitive dialogue, and to agree as much as possible while there is still more than one bidder remaining. Care should be taken that the principle of equality is observed and that allowing other bidders to improve their solutions does not discriminate against a very clear front runner. Legal advice should be sought where there is doubt.



Solution is Affordable to the local authority

- 779 A solution may be poor value for money but affordable, or it may be good value for money but nonetheless unaffordable. Before appointing a Preferred Bidder, the local authority will need to be satisfied that the solution offered is Best Value and is affordable. In this context, affordability means assessing the project cash flows (including the client-side management costs) over the duration of the Contract period, and making realistic assumptions about local authority budgets, indexation, the levels of interest to be earned on any cash balances and including contingency sums where appropriate.

Best Value

- 780 In evaluating solutions, the local authority should not seize on, or be unduly repelled by, short-term features unless they affect the Best Value of the project over the life of the Contract. This judgement needs to be made by looking at the whole-service/whole-life solutions offered by the bidders. For example, bidders may have different solutions to meet the Output Specification, with one choosing to have high up-front capital investment with lower future lifecycle and maintenance requirements, and another having relatively low initial capital investment but with more frequent lifecycle renewals and refurbishment. The local authority should concern itself with the overall results of the mix under the different approaches, rather than the balance of individual components within it. The temptation to cherry-pick solutions by comparing and contrasting constituent elements against each other should be avoided. As long as the approach meets the requirements of the Output Specification and is affordable, the solution offering Best Value in terms of whole-life costs should be accepted.

Service Provider is a Cohesive Entity

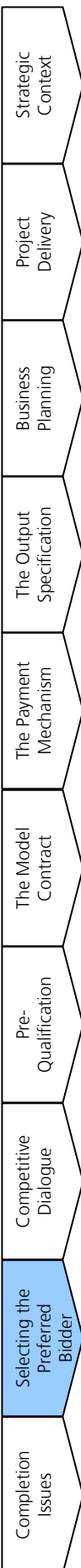
- 781 At the stage of selecting a Preferred Bidder, it is important that the proposed delivery structure is coherent and presents a deliverable project structure.

PFI Criteria

- 782 A PFI scheme will need to satisfy the PFI criteria set by the DCLG, the sponsoring department and PRG. An update of the FRS5 assessment will be needed, and the assessment confirmed, that that the transaction as structured will meet the off balance sheet test under FRS5.

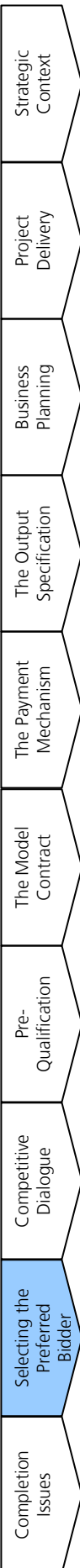
Preferred Bidder Letter

- 783 A letter from the local authority to the Preferred Bidder should set out the outstanding issues to be clarified and confirmed, and all parties should sign up to this before the Preferred Bidder is formally selected. A model Preferred Bidder letter is included as Model 13 of this Procurement Pack.

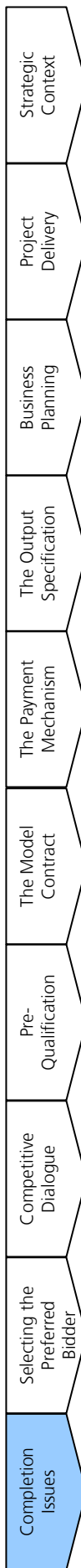


Section 2 Reserve Bidders

- 784 Under the negotiated procedure, it was common practice to appoint a Reserve Bidder at the same time as the Preferred Bidder was selected. Reserve Bidder status would mean that should negotiations with the original Preferred Bidder fail to reach financial close, the local authority would automatically offer the Reserve Bidder the opportunity for further dialogue.
- 785 A different approach is needed under competitive dialogue. By the time that competitive dialogue is closed 'all the elements required and necessary for the performance of the project' are expected to be in place with the Preferred Bidder; and in calling for final tenders the local authority should be clear about the details of the transaction. Post selection of a Preferred Bidder, agreeing the final details of the transaction are expected to be limited to 'confirming commitments' and 'clarifying aspects of the bid'. It is not expected that this final clarification work will amount to more than about three months in the majority of schemes.
- 786 OGC have issued guidance discouraging the use of Reserve Bidders. However, the OGC have also indicated that "...it is possible that problems will occur in the final bilateral phase which result in the authority reversing its initial decision to select a Preferred Bidder, although in practice this is relatively rare. In such circumstances, another minimum 10 day standstill period will need to be implemented if a new bidder is selected".
- 787 In 4ps view, whilst it is not appropriate to keep more than one bidder engaged in the final clarification stage (post selection of Preferred Bidder), in the event that the Preferred Bidder cannot clarify aspects of the final bid or confirm commitments, it remains open to the local authority to cease discussions with the Preferred Bidder at an appropriate stage and go back to the next best bidder. This is likely to be a rare and exceptional circumstance, but is nevertheless an important option.
- 788 Initially unsuccessful bidders reaching the final bid stage may be willing to remain 'on the sidelines' for a short while given the investment they have made in the process up to that date, and the relative short time envisaged to contract close with the Preferred Bidder.



**STREET LIGHTING
PROCUREMENT PACK
PART TEN
COMPLETION ISSUES**



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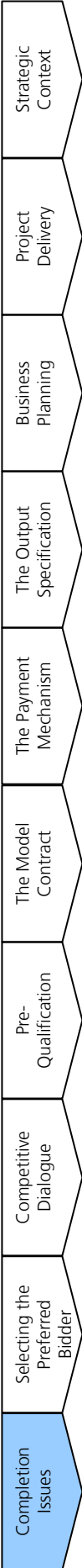
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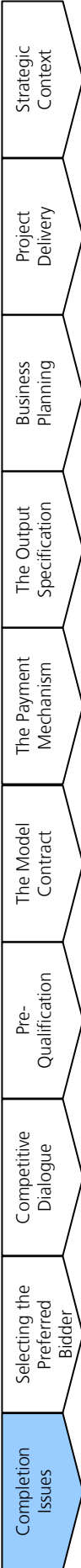
Section 1

Achieving Financial Close

- 789 Once a Preferred Bidder has been selected, details of the Contract can be clarified and confirmed, and the Final Business Case prepared to achieve financial close. Financial close is the point at which the Preferred Bidder finalises the swap taken out to finance the project. The point at which the Preferred Bidder and the local authority reach agreement on all the contract documents, resolve all technical issues, and agree the unitary charge for the provision of the service, is referred to as commercial close.
- 790 In an ideal world, all fine-tuning would have been completed before the selection of a Preferred Bidder, allowing 'close' to be a series of mechanical and housekeeping exercises from the local authority's point of view, with the service provider and its funders settling the ancillary documents and finance documents. In the real world, however, this rarely happens and there are often commercial points to clarify and confirm once the Preferred Bidder has been selected. Management of this period between the appointment of a Preferred Bidder and financial close is critical to the success of the procurement. What is achieved will depend largely on the development of an effective partnership between the local authority and the Preferred Bidder, where there is a mutual interest in achieving financial close, while still accommodating each party's requirements.
- 791 The work required from both parties to reach financial close should not be underestimated. The local authority needs a clear strategy, as well as individuals with the relevant expertise, for this phase of the procurement.

The Completion Strategy

- 792 In preparing for the final clarification and confirmation meetings, the focus should be on delivering a successful PFI/PPP project, and developing a partnership that can work for the period of the Contract.
- 793 The starting point is a realistic assessment of what the local authority would like to achieve from the clarification and confirmation meetings, and what the Preferred Bidder will be aiming for, and then setting the priorities for the discussions. Relevant project team members (or others, such as the risk management officer) should be assigned to meetings where their input, specialist expertise, or decision-making powers are required, and roles and responsibilities allocated. A realistic timetable is needed, with target dates agreed for completion of specific issues. Scheduling a larger number of shorter meetings on specific issues has been shown to be more productive than attempting to deal with a range of issues in a long meeting. Formal minutes of all meetings must record what has been agreed during the sessions.
- 794 The local authority will need to involve officers' senior enough to resolve issues as they arise. In most instances this should be the project director, but for specific issues the project owner may need to be involved in the clarification meetings. There may also be instances where a particular matter has to be referred to members, or other external commentator, such as the external auditor. The local authority also needs to be prepared to 'negotiate'. Clarifications and confirming the outstanding issues will not get very far if both parties are reluctant to move from their opening stance.



Managing the Process to Financial Close

795 The agreed timetable of events leading up to financial close should include all the processes that each party needs to undertake, and should reflect milestones and constraints such as:

- Local authority due diligence and internal approvals
- The time needed to clarify and confirm any remaining issues on the Contract and ancillary documents
- Any further design development that is required, or time required to complete any statutory processes
- Any deadline by which the project must reach financial close for funding reasons
- The time needed for any remaining Preferred Bidder due diligence to be completed and Bank credit committee meetings to take place
- The time needed to obtain an opinion on the accounting treatment of the project
- Relevant departmental review and approval of the Final Business Case.

Local Authority due diligence and Approvals

796 The local authority will need to complete its due diligence and must ensure that it has all necessary approvals for the project in line with the delegation of powers agreed for the project – some day-to-day decisions may have been delegated to the project director, but, for example, Members are likely to expect to approve the Final Business Case.

797 The local authority will need to take account of the lead times necessary for the submission of reports to cabinet, any scrutiny call-in periods, and the arrangements necessary for authorisation and sealing documents at financial close.

Contract and Ancillary Documents

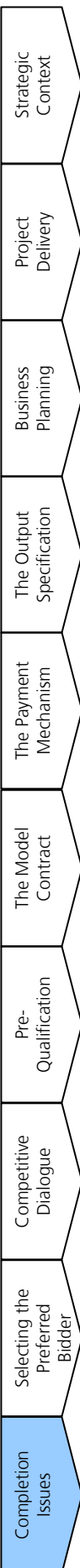
798 The basis of appointment of the Preferred Bidder will have included reference to an agreed mark-up of the Contract, and identification of any remaining issues to be clarified or confirmed. Strong project management will be needed to ensure that the timetable agreed with the Preferred Bidder is adhered to.

799 Appropriate time will also need to be incorporated into the timetable for finalising the ancillary documents, including the lenders direct agreement; the sub-contracts; and the method statements.

Design Development and Statutory Processes

800 Although bidders often reserve completion of the design solution until Contract signature, it is normal for the design development procedure and sample designs to be agreed prior to selection of the Preferred Bidder. A timetable for any clarification or confirmation work necessary between the selection of Preferred Bidder and financial close will need to be agreed. The contractual documentation will define how the parties are to proceed in agreeing final details of the scheme, as well as the review and consultation arrangements.

801 The local authority should also consider in advance of selecting a Preferred Bidder how to deal with any statutory processes, such as consents and approvals where this is necessary.



Deadlines

- 802 It is sometimes necessary for either the local authority or the Preferred Bidder to achieve financial close by a specific deadline date – for instance, if existing contracts are due to expire; if the time in which the PFI credits need to be drawn down is due to expire; if there is a fixed period within which the unitary charge is agreed; or if the Preferred Bidder needs to sign the project before its year-end. Practical issues may also be a factor in closing by a set date. Such deadlines should be anticipated and taken in to account when drawing up the timetable, but speed should be balanced against the need to deliver a strong long-term partnership.

Final Due Diligence and Bank approval

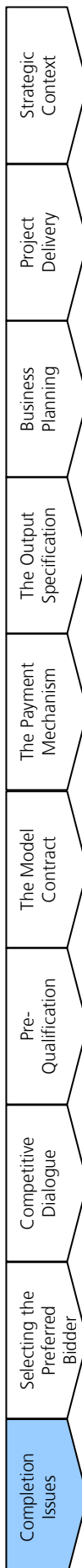
- 803 The Preferred Bidder's bank will be unable to complete its due diligence process prior to the actual appointment of the Preferred Bidder because some matters, such as completion of Contract confirmations, will not have taken place. Another reason is that the Preferred Bidder will be unwilling to incur the cost of the final due diligence without certainty of its recovery.
- 804 The local authority's position should be that it is acceptable for final due diligence to be undertaken after the appointment of Preferred Bidder, but it should be according to an agreed timescale and working towards a stated Bank Credit Committee meeting. It has been the experience in some projects procured under the negotiated procedure that matters arising out of the due diligence process have been a major cause of project delay and increase in costs. While the local authority should accept the need for the Bank to go through its necessary approval processes, it should also ensure that the Preferred Bidder has satisfied itself that its proposals are not likely to encounter difficulties at due diligence. The local authority should not generally accept any time or cost consequences of due diligence undertaken after confirmation of Preferred Bidder status.

Avoiding Changes

- 805 Changes to the scope of the project or the Output Specification after Preferred Bidder appointment should be avoided. The local authority should follow through any changes that are necessary (within the confines of clarification and confirmation) to the financial model and the change in unitary charge, ensuring transparency at all stages.
- 806 Any changes must also fall within the scope of those permitted under the Procurement Regulations as there are limits on the extent of permissible changes and the manner in which they can be made.

Changes in Cost

- 807 The affordability of the project will be one of the most important issues for the local authority to consider and confirm in the Final Business Case. Ideally, the only matter that will affect affordability at this stage will be changes in the interest rate attached to the bank debt raised for the project by the Preferred Bidder, and the impact of that on the unitary charge.
- 808 This is a risk that the local authority carries from the time of appointment of the Preferred Bidder up to financial close. There should be a strategy to monitor changes in interest rates and the impact on project affordability. Ongoing liaison with the Preferred Bidder will ensure that the local authority has as much certainty as possible of the final unitary charge at financial close.



Section 2 Accounting Treatment

Introduction

- 1 This Part of the Procurement Pack provides guidance to local authorities on how to address the accounting treatment of PFI schemes.
- 2 Local authorities prepare their accounts in accordance with the Code of Practice on Local Authority Accounting: A Statement of Recommended Practice ('the SORP'). The SORP involves interpretations of accounting standards and other pronouncements by the Accounting Standards Board (ASB) including FRS5 Reporting the Substance of Transactions Application Note F - PFI and Similar Contracts which was published on 10 September 1998.
- 3 Treasury issued Technical Note No. 1 (Revised) – How to Account for PFI Transactions ('the Technical Note') in July 1999. The SORP states that 'the status of the Technical Note for local authorities is that they are not within its scope, but practitioners might find its contents of interest in informing their consideration of the SORP's requirements derived from FRS5 to account for the substance of a transaction rather than its form.'

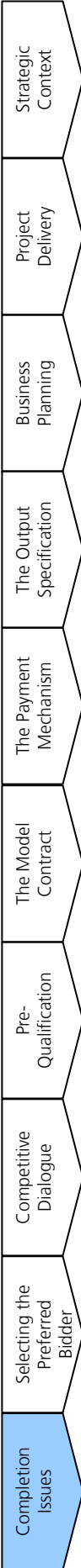
International Financial Reporting Standards (IFRS)

- 4 In the Budget on 21 March 2007 the Treasury announced that the public sector including local authorities will be moving to International Financial Reporting Standards (IFRS) from 2008-09. There is no IFRS standard for public sector accounting yet and none is expected for several years. However, there is a private sector accounting standard for operators 'IFRIC Interpretation 12 Service Concession Arrangements' (IFRIC 12). This is fully recognised by Treasury and the Financial Reporting Advisory Board (FRAB) and they have agreed to work together to provide IFRS standards for the public sector in the Financial Reporting Manual (FRm) based on relevant existing standards from 2008-09. This is not expected to be incorporated into the SORP until 2010/11.
- 5 We expect that many projects that are 'off balance sheet' under the Technical Note will be 'on balance sheet' under the public sector IFRS rules. However, DCLG are proposing to amend the capital finance regulations and the calculation of Minimum Revenue Provision so that the impact on the 'bottom line' of the Income & Expenditure Account is neutral for most projects between off and on balance sheet treatment. Local authorities should take account of the impact of on balance sheet treatment on their prudential indicators though.

Timetable

- 6 To avoid any late "surprises" in the proposed accounting treatment for PFI schemes it is important that local authorities and their financial advisors assess the accounting treatment throughout the procurement process, keeping the auditors fully informed during this process.
- 7 The Technical Note highlights the stages at which the accounting treatment should be reviewed. This is updated below in table 10.2.1 for the impact of competitive dialogue, and it is recommended that the following outputs are obtained at the different stages of procurement:

Table 10.2.1 – Stages for assessing the Accounting Treatment



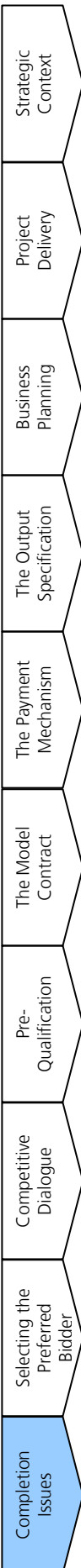
Stage	Output
Outline Business Case (OBC)/Pre Invitation to Submit Detailed Solutions (ISDS)	Provide an initial view on the accounting treatment based on the draft ISDS and OBC documentation. This will be a high level review based on the expected structure of the contract.
Preferred Bidder	Update initial view to provisional judgement based on the design solution/financial model of the preferred bidder.
Pre contract signature	Provide a final judgement subject to any late contractual changes.

- 8 In most instances it will be sufficient throughout the competitive dialogue process to maintain under review the 'Initial View' prepared at the OBC stage and prepare the provisional judgement on selection of the preferred bidder prior to the completion of the final negotiations and approvals.
- 9 However where uncertainty exists as to the outcome of the potential accounting treatment of the scheme and sufficient certainty exists as to the nature of the scheme's likely final design solution, consideration should be given to preparing the provisional judgement following receipt of the bidders' detailed solutions. This will however need to be considered on a case by case basis.
- 10 A summary of the stages and the proposed outputs is shown in figure 10.2.2 below.

Figure 10.2.2 – Stages and Proposed Outputs

Stage:	Output
Outline Business Case (OBC)	Provide an initial view on the accounting treatment based on the OBC documentation. This will be a high level review based on the expected structure of the contract.
Invitation to Submit Detailed Solutions (ISDS)	Review and if necessary update the initial view and where the accounting treatment is borderline consider on a case by case basis whether to produce a provisional judgement on the ISDS submissions.
Preferred bidder	Update initial view (or previous provisional judgement) to provisional judgement based on the design solution/financial model of the preferred bidder.
Pre contract signature	Provide a final judgement subject to any late contractual changes.

- 11 The local authority should involve its external auditors at each key stage above by seeking comments on the accounting outputs.

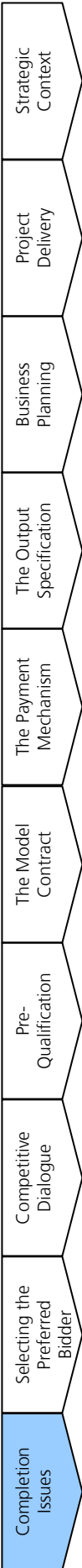


Section 3 The Final Business Case

- 809 If the local authority is seeking central government financial support towards the costs of the PFI project, the relevant department will require a Final Business Case (FBC) to be prepared. This will form the basis of the departmental final approval for the scheme and, assuming that the FBC is approved, allow the department to award the Promissory Note for the PFI Credit for the project. The FBC should provide documentary evidence to show how the agreed Contract has met the objectives and key criteria developed for the scheme at the time of preparing the OBC, and any subsequent amendments to those objectives and key criteria made during the procurement process.
- 810 The FBC may also be a useful way of reporting to Members the position on the agreed Contract, and the means of seeking Member approval for the subsequent award of the Contract. In most cases Contract signature is likely to follow shortly after the approval of the FBC by Members and, where appropriate, the relevant department. Local authorities will, however, have their own reporting and decision-making structures for the final approval of a project before the Contract can be signed, and will need to determine how the preparation of the FBC should be organised alongside these.
- 811 Local authorities will need to determine if the FBC is to become a public document (having regard to the requirements of the Freedom of Information Act), and, if so, how any commercially sensitive information included in the FBC should be identified and subsequently removed from the public document (following Member and departmental approval).
- 812 This remainder of this Section of the Procurement Pack offers a suggested approach to the structure of the FBC which is based on that used by a number of local authority PFI schemes now in operation. Following an Executive Summary, it should demonstrate how the proposed solution will meet the local authority's objectives for the project; give the agreed position on the financial issues, affordability, risk allocation, and accounting treatment; outline how stakeholders have been involved; summarise the competitive procurement process followed; and set out the final position on the Contract and Payment Mechanism.

Executive Summary

- 813 This section of the FBC should provide a short summary of the key issues included in the detailed sections of the FBC (as discussed below). It might usefully include a succinct description of the agreed project, with appropriate commentary on the following issues:
 - The service provider
 - Term of the Contract
 - The new facilities and investment regime agreed and included in the Contract
 - The economic and service benefits of the project
 - The fit of the project with other local authority policies and strategies, such as the service strategy
 - The service delivery arrangements and service provider's approach compared to that envisaged in the Reference Project and OBC
 - A summary of the performance standards and performance targets agreed with the service provider, including, where appropriate, how these fit with any statutory targets.



814 The aim should be to keep this Executive Summary to a maximum of two to three sides and to ensure that all of the pertinent issues relating to the PFI Contract are addressed.

Project Objectives

815 The OBC will have included a series of aims and objectives for the project, and ideally the same aims and objectives will have been used throughout the procurement process and be reflected in the Descriptive Document, Output Specification, and ISDS. The model documentation included in this Procurement Pack assumes that this would be the case, and wherever possible there is appropriate cross-referencing to facilitate this approach.

816 The FBC should set out how the proposals in the agreed Contract meet the objectives developed as part of the OBC, and if there are departures from those objectives, the reasons should be given for this. If the objectives have been developed further since the OBC was approved by members (and the PRG if appropriate), or if new requirements have come to light during the procurement process (such as successor standards to those envisaged at the time the OBC was prepared), appropriate commentary should be included in the FBC on each issue.

Financial Issues and Affordability

817 This section of the FBC should set out the agreed position on:

- Value for money – confirmation that the project offers value for money in accordance with a Stage Three assessment set out in the HM Treasury *Value for Money Assessment Guidance*
- CPA and Best Value – a description of how the project fits with the local authority's CPA and Best Value strategy for the service, and how Best Value will be measured throughout the term of the Contract
- Affordability – the local authority will have made an assessment of the affordability of the project at the OBC stage. This computation should be updated using out-turn figures for the agreed PFI/PPP Contract. Commentary should be included on how any material changes since the OBC was prepared are to be dealt with.

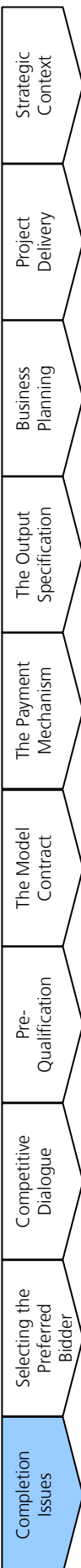
818 Supporting schedules (not necessarily detailed financial models) for each of these factors should be included as appendices to the FBC.

Stakeholder Consultation

819 The FBC should outline how the relevant stakeholders have been consulted throughout the procurement of the project, referring to:

- Internal Stakeholders – outlining how the project has been developed by the project team, in consultation with Members, the strategic project board, the stakeholder board, relevant departments and other internal stakeholders
- Community and Staff – outlining how the local community and relevant staff have been consulted throughout the process.

820 The FBC should also explain how the consultation arrangements are to continue throughout the term of the Contract, both during the build or investment period, and thereafter.



Procurement Process and Competition

821 The FBC should include a summary of the competitive process followed in the selection of the service provider, and the decisions taken at each stage of the procurement process. As a minimum, it is suggested that appropriate commentary be included in the FBC on these stages:

- Pre-Qualification
- Short-listing from the initial competitive dialogue stage
- The conclusions from the detailed solutions (and refined solutions) stages
- Selection of Preferred Bidder (and Reserve Bidder where appropriate)
- Fine-tuning to financial close
- Any issues arising from a Stage Three assessment in accordance with the HM Treasury *Value for Money Assessment Guidance*.

Risk Allocation and Accounting Treatment

822 A section should be included in the FBC summarising the agreed position on the allocation of key risks associated with the project. In particular, there should be appropriate commentary on those areas where there has been departure from the risk allocation position envisaged at the time the OBC was prepared.

823 The local authority will need to determine if the transaction will meet the requirements of FRS5. The FBC should include a statement on the accounting position of the transaction under FRS5. Copies of the relevant opinions on the local authority's accounting treatment under FRS5 prepared by the local authority's chief financial officer and its external auditor should be included as appendices to the FBC.

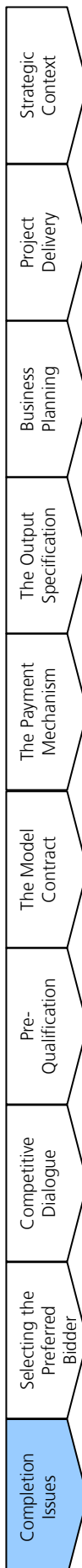
Contract and Payment Mechanism

824 The FBC should set out the final position on the vires for the PFI/PPP project and state whether any statutory processes have still to be completed, such as planning permissions. If appropriate, details of how and when those statutory processes will be progressed, and where the risk and responsibilities for completing the work lie, should be included.

825 A summary of the key contractual issues agreed as part of the PFI Contract should be included in the FBC. Any derogations from the department and HM Treasury approved sector specific contract as regards *Standardisation of PFI Contracts* issues should be set out (probably in the form of a table) in an appendix. This should include the reasons for those derogations, and an indication of the impact of not adopting the approach as set out in the sector-specific contract (i.e. the position set out in the Model Contract included as part of this Procurement Pack). The legal advisors to the project should be responsible for preparing such a table. The table should be approved by the project director, together with the local authority's monitoring officer.

826 Some sponsoring department require a copy of the agreed PFI Contract to be submitted with the FBC.

827 Commentary should also be included in this section of the FBC on pertinent aspects of the Payment Mechanism agreed with the service provider, such as key components of the Payment Mechanism.

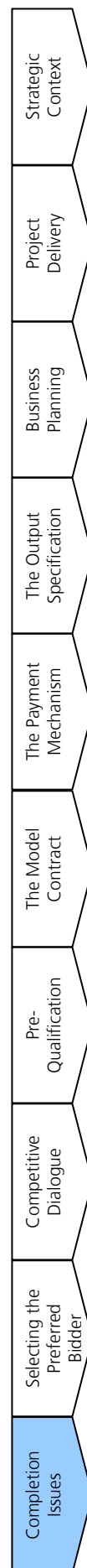


828 Commentary might also usefully be included in this section of the FBC on the key commercial issues specific to the PFI/PPP project.

Contract Management and Performance Monitoring

829 The FBC should set out how the objectives for the project will be used in contract management and performance monitoring.

830 The FBC should set out how the performance of the service provider will be monitored, both during the build or investment period, and for the services period.



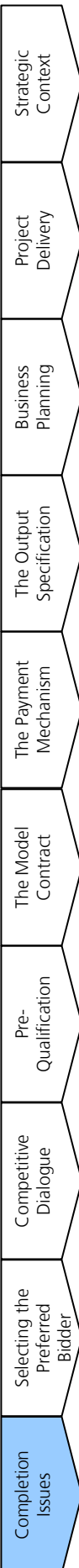
Section 4 Local Authority Certificates

'Alcatel' Contract Completion Requirements

- 831 As part of the completion arrangements, local authorities need to comply with the requirements of the Alcatel judgment. The requirement is to put into effect a 10 calendar day stand-still period between notification of an award decision to a successful bidder, and the entering into a contract with that bidder. This period is designed to allow unsuccessful bidders a reasonable opportunity to apply to court for interim measures (injunctive relief) which could lead to the award decision being overturned where the complainant has a case which finds favour with the court. If there is a legal challenge, local authorities should wait to see if interim measures are granted before proceeding.
- 832 The Alcatel stand-still requirement applies to all public sector procurements caught by EU procurement directives and ensures that at the time of the announcement of the award decision the local authority will not have entered into a binding contract with the winning bidder. The standstill is aimed at making the procurement process more evidently fair and transparent at the contract award stage.
- 833 Notification of the contracting authority's award decision must contain:
- Award criteria
 - Where appropriate, the bidder's score
 - Where appropriate, the winning bidder's score
 - The name of the winning bidder.
- 834 There are also new debriefing rules which include:
- Providing additional debriefing within the standstill if requested by the end of the second working day of the standstill period
 - Allowing three working days between this debriefing and end of the standstill.
- 835 It is essential for each local authority to take legal advice on this issue and also to pay attention to developments and any further announcements by the relevant Government departments such as OGC and DCLG.

Contracts Act

- 836 4ps have produced *A Guide to the Local Government (Contracts) Act 1997 – A Practical Guide to the Provisions and their Effect*. It is important that local authorities make appropriate provisions for completing the local authority certificates, particularly since these may be a 'condition precedent' in the Contract. Local authorities and their legal advisors are advised to consult the 4ps guide when developing the Model Contract, and subsequently when finalising the Contract, to ensure that the relevant steps are taken.



**STREET LIGHTING
PROCUREMENT PACK
APPENDIX ONE
OTHER RELEVANT GUIDANCE**

Other Relevant Guidance Material and Links

4ps (020 7808 1470 or www.4ps.gov.uk)

A Guide for PFI and PPP Project Directors and Project Owners

A Guide to Procuring Local Authority Transport Schemes and Services

A Map of the PFI Process using Competitive Dialogue

Employee Disclosure and Consultation with Staff and Others

Guide to the Local Government Contracts Act

Project Information Briefing – Portsmouth City Council Highways Management PFI Scheme

Protections – Local Authority PFI Procurement and Contracts

Standardisation of PFI Contracts 2004 – Local Government Supplement

The Final Business Case

The Outline Business Case

Workforce Contract Guidance (in conjunction with EO/IDEA/4ps)

HM Treasury

Green Book – Appraisal and Evaluation in Central Government

PFI: Meeting the Investment Challenge, 2003

PFI: Strengthening Long Term Partnerships, 2006

Standardisation of PFI Contracts

Technical Note 1 - How to Account for PFI Transactions

Technical Note 3 - How to Appoint and Manage Advisors to PFI Projects

Technical Note 4 – How to Appoint and Work with a Preferred Bidder

Technical Note 6 – How to Manage the Delivery of Long-Term PFI Contracts

Technical Note 7 – How to Achieve Design Quality in PFI Projects

Value for Money Assessment Guidance, 2004

Department for Transport (www.dft.gov.uk)

Guidance on Multi-Modal Studies (GOMMS)

Guidance on Local Transport Plans

Guidance on the Appraisal of Street Lighting Projects (issued June 1999)

Department for Communities and Local Government (www.communities.gov.uk)

Best Value and Audit Commission Performance Indicators

Circular 02/2001 – LGA 1999 – Section 19 – Best Value and Procurement – Handling of Workforce Matters

General Criteria for PFI Schemes

Institute of Lighting Engineers (01788 576492)

A Practical Guide to the Procurement of Street Lighting Projects through the PFI

Audit Commission (0800 502030)

Building for the Future – The Management of Procurement under the Private Finance Initiative

Cabinet Office (www.cabinet-office.gov.uk)

Guidance on Staff Transfers in the Public Sector

Other

Public Contracts Regulations 2006

**STREET LIGHTING
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APPENDIX TWO
BRENT CASE STUDY**

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Section 1

Executive Summary

- 837 The London Borough of Brent (Brent Council) was the first local authority to procure its street lighting service through the Private Finance Initiative (PFI). The Contract for the scheme was signed in December 1998 and the project is now fully operational. In 1999, the 4ps project support team produced a Case Study on the process followed by Brent Council in developing and implementing the scheme. The Case Study in this Appendix to the Procurement Pack is an updated version, which also takes account of more recent practice and guidance (guidance and commentary is shown in italicised text). It provides a useful insight into the working of the procurement arrangements for such schemes: of how the process is initiated, developed and implemented. It gives local authorities the opportunity to gain a general understanding of the approach before embarking on their own projects.
- 838 This Case Study examines the arrangements reached between the Brent Council and the service provider - PFI Lighting Limited (a consortium consisting of David Webster Ltd. and Société Générale) for the provision of a street lighting service under the Private Finance Initiative (PFI). The project brings considerable benefits compared with what would have been possible through conventional procurement, in particular the early implementation of a lighting service to modern standards that should contribute towards improvements in road safety and reductions in the fear of crime.

Background to the Brent Scheme

- 839 Brent Council identified an urgent need to bring its street lighting stock of some 21,000 items up to modern standards in 1996. Previous under-funding of maintenance and the lack of investment in new stock had contributed to the progressive deterioration of the street lighting stock and the failure to achieve modern service standards. Various surveys of the condition and effectiveness of lamp columns, control columns, feeder pillars and underground cabling indicated that significant levels of investment were necessary to reverse the cycle of deterioration and increasing unreliability, and bring lighting levels up to modern standards.
- 840 Analysis of road accident statistics in the Brent Council showed a direct correlation between lighting improvements and a reduction in after dark-road accidents. In addition, a Residents Attitude Survey conducted by MORI in 1996 identified community safety as a priority concern of residents and highlighted more effective street lighting as a significant element in improving community safety and combating crime and the fear of crime. This latter point was supported by a survey undertaken by the British Parliamentary Lighting Group.
- 841 In 1994 Brent Council had launched a new street lighting maintenance regime and had introduced a systematic programme of work to address some of the basic safety and urgent maintenance requirements. However, this new regime only underlined the seriousness of the deficiencies in Brent Council's lighting service and the increasing amount of maintenance work needed just to keep the lighting infrastructure serviceable.
- 842 The inclusion of a street lighting project in Brent Council's Economic Development Plan for 1997/98 and in the Crime Prevention and Community Safety Strategy developed jointly by Brent Council, Metropolitan Police, Probation Service and Health Authority, reflected the priority given to street lighting improvements. Various options for improving the service had been considered by Brent Council, and Members formally approved investigating the opportunities for using the PFI for the street lighting service in July 1996.

The PFI Solution

- 843 The street lighting service was relatively easy to specify in terms of outcomes or performance, particularly when compared to some other local authority services. However, the procurement of a street lighting service through the PFI, and the development of a service based around an Output Specification, did require some new thinking and a move away from the use of detailed input measures that had previously been used in the maintenance regime.
- 844 The approach adopted by Brent Council transfers responsibility for all key aspects of the service to the service provider. The service provider is, therefore, responsible and accountable for the design, installation, operation (including energy supply), maintenance and financing of the street lighting service.
- 845 The key features of the partnership solution developed by Brent Council and PFI Lighting Limited were defined as:
- To deliver a street lighting service to the British Standard 5489 or the equivalent (*local authorities are now typically specifying EN 13201*). The service was specified as a series of outputs, lighting levels, not inputs, equipment types and numbers required
 - An initial investment period in which the service provider is required to bring lighting levels up to the defined British Standard and make safe all equipment (this period is subsequently referred to as the Core Investment Period). During this period some 11,000 new columns will be installed, 4,000 columns will be converted to meet the required British Standard, 4,500 metres of new cabling will be installed and 1,000 illuminated signs will be replaced. The cost of this core investment is some £8 million and the DfT has provided a PFI Credit towards this capital investment. The service provider is required to provide the existing service whilst upgrading the stock to the required levels.
 - A series of performance standards have been defined against which delivery of the service will be monitored.
 - The Contract provides for the service provider to provide a lighting service for a 20-year period and is worth in excess of £45 million (Net Present Value) over the Contract term. Payment commenced upon Contract award for the service taken over but reductions are made against the total Unitary Charge until the Core Investment Programme has been completed and service delivery targets achieved. The payment mechanism is structured to incentivise the service provider to meet the programme of core investment.
 - At the end of the Contract term the service obligations relating to the Apparatus will revert to Brent Council and all stock must have a minimum remaining life of at least five years. During the period of the Contract, the service provider has a concession to operate the service on behalf of Brent Council, but has no ownership rights over the assets.

Benefits of the PFI Approach

- 846 The most obvious benefit of the PFI for Brent Council has been the access to an alternative source of finance to enable it to develop a project that addresses the deterioration of its street lighting service resulting from under-investment in the infrastructure. The availability of resources for local authority PFI projects has enabled Brent Council to improve the street lighting service much sooner than was likely to have been possible using traditional sources of funding. Procuring the project through the PFI has also allowed Brent Council to transfer the main risks for delivering the service to a private sector service provider.

847 Value for money savings have also been achieved by using the PFI. These savings have been achieved through a number of key factors: the whole service approach; efficiencies from integrating design, installation, maintenance and operations; linking responsibility for management and performance; and through giving the service provider the ability to optimise spend-to-save opportunities available from innovation, technological change and contracting flexibility. A further benefit for Brent Council is the fact that payments for the street lighting service are now directly linked to the delivery of agreed performance standards.

The service provider - PFI Lighting Limited

848 PFI Lighting Limited is a Special Purpose Vehicle created by David Webster Limited and Société Générale. Probably the greatest benefit to the service provider of the PFI approach is that it will provide the partners with a secure income stream for the period of the Contract, so long as they are able to deliver the service to the agreed performance standards. The other benefit of the PFI approach is that it makes the service provider responsible for all aspects of the service. In this way, the service provider is given the flexibility to innovate and determine the appropriate investment needs over the period of the Contract. The service provider is responsible for managing the key aspects of service delivery; how effectively they do that will determine their reward.

Key Messages

849 Brent Council and the service provider acknowledge that they must continue to work in partnership if the street lighting service is to be delivered in the most effective way and, if both parties are to optimise their expectations.

850 The successful completion of this PFI scheme was brought about by a number of contributory factors, in particular:

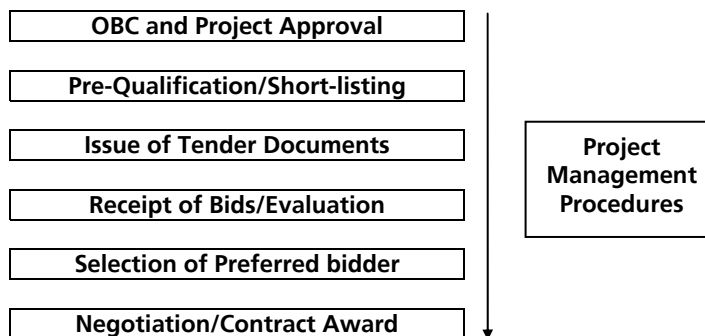
- The demonstrable commitment of the Members to improve the street lighting service in Brent Council
- The clear need for the project identified as part of a wider strategic review and supported by consultation with local residents and other organisations
- The quality of the project team, which was led by a Deputy Director, and with participants who possessed the key skills to deliver the project
- Detailed consideration of key issues and costs, and the development of a comprehensive outline business case before procurement commenced.

Section 2 The Procurement Process

Overview of the Process

- 851 The Contract for the street lighting PFI scheme in Brent Council was signed on 1 December 1998 with the new service becoming operational immediately. The decision to proceed with the PFI approach was taken by Brent Council in July 1996 with the official advert in the European Journal being placed in January 1997. The total lapsed time of the procurement process was therefore 23 months. Although this appears a lengthy procurement, much of this time was spent on the final negotiations that were delayed to assess the impact of the introduction of amendments to the Capital Finance Regulations by the DCLG, and because of protracted negotiations and wider consultation over the consequences of early termination.
- 852 The key stages in the procurement process followed by Brent Council are shown in figure A1 below:

Figure A1 – Key stages in the Procurement Process



Lessons Learned from the Brent Council Pathfinder Project

- 853 This was the first time that the PFI had been used for the procurement of a street lighting service and inevitably the process was quite lengthy. Project managers from both Brent Council and the service provider have acknowledged that the procurement of this project was relatively expensive and time consuming as new technical, contractual and financial issues had to be addressed. This and subsequent experience, and guidance material produced by the 4ps and others, have significantly reduced the time and cost factors for local authorities now procuring similar schemes.
- 854 *The completion of the Contract for the Brent scheme could have been achieved earlier if a number of key issues had been in place or could have been dealt with without difficulty. The issues that delayed completion have now largely been addressed, and other local authorities using the PFI for their street lighting service should not face delays as a result of these issues. In particular, the uncertainty of funding has now been removed with the introduction of the interdepartmental Project Review Group assessment and 'sign-off' of projects requiring central government support prior to commencement of the procurement process. In addition, a number of helpful changes have been made by the DCLG to the Capital Finance Regulations that now assist street lighting schemes.*

Outline Business Case

- 855 Officers prepared a Committee report in July 1996 setting out the key concerns with the street lighting service in Brent Council and the options available to Brent Council to improve service provision. Members gave approval to officers to investigate further the procurement options, including investigation of the PFI option. Initial discussions were held with the 4ps project support team in October 1996.
- 856 At that time the rules for local authority PFI were still being developed and there remained some uncertainty about whether to proceed along a PFI route. Changes to the Capital Finance Regulations and the introduction of revenue support towards qualifying local authority DBFO schemes in October 1996 gave the necessary encouragement to Brent Council to investigate further the option of using the PFI for the street lighting service. There did, however, remain a number of concerns, particularly since the proposed project was substantially different to those schemes that had previously been signed (such as roads and prison projects). Some of this uncertainty continued throughout the procurement process and Counsel's opinion was sought on a number of specific issues.
- 857 Some 'soft' market testing was undertaken during the latter part of 1996 to gauge the level of private sector interest in the proposed scheme. This exercise indicated that there was likely to be significant levels of interest in working with Brent Council on this project and gave Brent Council the necessary comfort to go ahead with the PFI Scheme. The project was selected as a 4ps project support Pathfinder in November 1996 and a 4ps project support executive was a member of the project board for the project.
- 858 The preparation of an Outline Business Case (OBC) commenced at about the same time. The purpose of this work was to review further the options available to Brent Council and to assess the likelihood of the proposed scheme meeting the appropriate value for money and legal framework tests. Advisors were appointed in January 1997 to assist Brent Council with this work. The investment appraisal and business planning work demonstrated that the PFI was a viable option for the street lighting service and was approved by Members.
- 859 *Local authorities are advised to seek appropriate assistance at an early stage to assist with this phase of the work. The guidance produced by the 4ps project support team The Outline Business Case has been amended to reflect the particular needs of a street lighting scheme and this guidance is included in Part 2 of this Procurement Pack.*
- 860 *Local authorities should determine as part of the business planning process the type and level of external assistance required and how that assistance will be used during the procurement process. Brent Council did not appoint external financial and legal advisors until quite late in the process and it is recommended that other local authorities give appropriate consideration at an early stage to the need for, and role of, external advisors. Where necessary, reference should be made to the HM Treasury guidance Appointing and Managing Advisors. If the local authority expects the PFI to become a normal procurement tool in the delivery of its services, it is also important that officers from the local authority develop their own skills, such as by working alongside the external advisors, to minimise the procurement costs of subsequent schemes.*
- 861 Two key aspects of the work undertaken by Brent Council as part of the business planning process were options appraisal and funding and affordability.

Options Appraisal

- 862 An appraisal was undertaken to review the project and procurement options available to Brent Council for the delivery of the street lighting service. The project options considered were the continuation of the existing services; the 'do minimum' option (make safe and maintain); the fast-track improvement of selected (prioritised) columns; and the full replacement of stock. The appraisal assessed each of the options against both non-financial and financial criteria. The evaluation criteria used for this exercise included time-scale, safety and service standards, lighting standards, quality of infrastructure, maintenance efficiency and contribution to Brent Council's wider strategic aims.
- 863 The option of 'Fast Track Renewal' was considered to offer the pattern of inputs and outputs that best met the project objectives at the optimum whole life costs. This option was therefore, taken forward to the second stage of the appraisal as the preferred investment option, and the basis for identifying the most suitable procurement route. The do-minimum option was also taken forward to provide a value-for-money benchmark.
- 864 The procurement options considered by Brent Council included leasing, traditional funding (Basic or Supplementary Credit Approval), joint procurement with neighbouring local authorities, a joint venture approach, separate investment, maintenance and energy Contracts and PFI/DBFO procurement. Each option was reviewed against the project objectives, and a short-list was identified for detailed evaluation.
- 865 A preliminary assessment of risk was also carried out for each of the options, together with an assessment of the likelihood of availability of funding and affordability. The key conclusion of the appraisal was that the PFI route would offer the best overall value for money and was clearly the preferred option on all parameters. It was also the only route that offered a practicable solution for securing the necessary investment to achieve the necessary improvements in lighting infrastructure and services across the Brent Council area.
- 866 *The DfT has now produced specific criteria as to how local authority street lighting PFI projects will be appraised. The new methodology was issued by the DfT in June 1999 and is based on the Guidance on Multi-Modal Studies (GOMMS). An Appraisal Summary Table (AST) and supporting worksheets are now required for any transport scheme seeking central government support, and local authorities developing street lighting projects will need to comply with this new requirement. Guidance on the appraisal of options for street lighting projects and the completion of the AST is included in Part 2 of this Procurement Pack.*

Funding and Affordability

- 867 As part of the business planning work, Brent Council determined the proportion of the total costs relating to capital investment needed to bring the equipment up to standard and the relevant level of abatement. When the Best and Final Offers (BaFO) were received, the revenue element included in the bidders' financial model was very close to the level that had been calculated at the OBC stage. However, the DfT subsequently determined that the NPV of the capital investment during the Core Investment Period (from the bidder's financial model) would form the basis of the PFI Credit.

868 *One of the issues that remained unresolved until relatively late in the procurement of the Brent Council scheme was the amount of central government support towards the project in the form of PFI Credits. In June 1999 the DfT issued revised methodology for assessing the value of the PFI Credit for street lighting schemes. Details on this methodology and guidance on the calculation of the PFI Credit is included in this Procurement Pack. Local authorities developing street lighting PFI schemes will need to address this issue at the OBC stage to enable an assessment of affordability to be made. The interdepartmental Project Review Group will require a clear commitment from the local authority's Members to the affordability of the project.*

Project Approval

869 Brent Council submitted their OBC to the DfT in April 1997 in support of its application for a PFI credit (revenue support) towards the capital investment included in the proposed scheme. At this time, PFI in local authorities was still very much on a 'first come, first served' basis and final approval was not generally given until late in the process. This lack of certainty meant that Brent Council was taking significant risk in moving forward without Central Government commitment to the scheme. The street lighting scheme in Brent Council eventually received PRG 'sign off' in November 1997. *This uncertainty has now been removed with the introduction of the interdepartmental Project Review Group assessment of projects requiring central government support and the signing-off of projects prior to commencement of the procurement process.*

Project Management

870 A core project team was assembled by Brent Council at the outset of the process and remained substantially intact throughout the procurement. The Project Team was chaired by the Deputy Director of Environmental Services who led the procurement and negotiation process and was closely involved at all stages. *It is important that other local authorities considering street lighting PFI projects similarly designate a sufficiently senior officer to this role.*

871 The Project Team possessed all the relevant skills (technical, financial and legal) and was sufficiently small and responsive to be able to make the speedy decisions that needed to be taken throughout the development and procurement of this project. A 4ps project support executive was a member of the project board throughout the procurement process.

872 Brent Council appointed technical and engineering, financial and legal advisors to work alongside the Project Team.

873 A detailed project management plan and timetable was drawn up at the outset and reviewed throughout the procurement process. Brent Council acknowledged early on in the process that it was going to be difficult to keep to the proposed timetable. However, the initial timetable was drawn up around a programme to try and let a PFI Contract before the expiry of its existing maintenance Contract for the street lighting service on 30 September 1997, in order to avoid further extensions to this Contract.

874 A copy of the projected timetable and the actual timetable is shown in figure A2.

Figure A2 – Actual and Projected Timetables

	Planned	Actual
Outline Business Case	March 1997	April 1997
DfT Approval	March 1997	November 1997
OJEU Notice	January 1997	3 January 1997
Expressions of Interest	February 1997	14 February 1997
Pre-Qualification Submission	March 1997	7 March 1997
Long-list	April 1997	7 April 1997
Short-list	April 1997	21 April 1997
Issue of ISDS	May 1997	10 May 1997
First Offers	June 1997	10 June 1997
Best and Final Offers	August 1997	15 August 1997
Selection of Preferred bidder	October 1997	15 September 1997
Contract Award	October 1997	December 1998

875 As can be seen from the timetable, the total lapsed time of the procurement process was 23 months. The table shows that most slippage related to the final negotiations. The negotiations with the Preferred Bidder were delayed to assess the impact of amendments to the Capital Finance Regulations and because of protracted negotiations over the consequences of early termination.

876 *Although the procurement was lengthy and time consuming, it is important to remember that this was the first time that such a service had been procured through the PFI and many new issues had to be addressed without suitable precedents. Local authorities considering the development of similar schemes should refer to the guidance on developing the procurement timetable in Part 3 of this Procurement Pack. Local authorities are advised to allow for a minimum period of 15 months between issue of the OJEU notice (following project sign off if central government revenue support is to be sought) and Contract close.*

Pre-Qualification and Short-Listing

877 The procurement process for the Brent Council scheme was formally commenced in January 1997 with the publication of an official notice in the European Journal (OJEU Notice). An Information Pack was prepared to accompany the official advert, together with a pre-qualification questionnaire and guidance as to what was expected from those wishing to submit proposals to work with Brent Council.

878 *Local authorities seeking Central Government Support towards their projects are reminded that an OJEU notice should not be placed until after the project has received endorsement from the interdepartmental Project Review Group.*

879 *Other local authorities have held a bidders Conference or Open Day as part of the pre-qualification/short-listing process. This can be a useful way of expanding on what is included in the Information Pack and provides an early opportunity for bidders to ask questions about the proposed procurement.*

880 Seventeen companies responded to the advertisement and requested an Information Pack from Brent Council. Eleven of these companies' subsequently submitted proposals to undertake the street lighting service.

881 The evaluation by Brent Council to arrive at a short-list of bidders was carried out in two stages. Bidders were initially judged on their technical expertise (including track record) and financial capability to undertake the service. This first stage of pre-qualification resulted in a long-list of five companies who were invited to present their outline proposals to Brent Council. Brent Council also requested references for each of the long-listed bidders. Following this process, three consortia stood out as best placed to deliver the required service and were short-listed to go forward to the next stage.

Invitation to Negotiation (ISDS)

882 Brief clarification meetings were held with each of the short-listed bidders as part of the process of developing the ISDS to ensure that the bidders had a good understanding of the way in which Brent Council wanted to develop the street lighting service through the PFI. This also provided an opportunity for Brent Council to outline to the bidders the proposals to take forward the procurement. The ISDS was issued to the three short-listed bidders in May 1997 and included the following:

Instructions and Guidance to bidders - the Instructions set out Brent Council's requirements in terms of Bids, including what was allowable as variant Bids. The Instructions also defined the proposed programme for replacing and upgrading columns during the Core Investment Period.

883 **Output Specification** - the Output Specification set out the broad parameters and standards of lighting required. It focused on what was required rather than how it was to be achieved.

884 **A Draft Contract** – *The guidance and model documentation in the 4ps Procurement Pack, and the HM Treasury guidance Standardisation of PFI Contracts, should be used to develop the Model Contract for issue as part of the ISDS for a street lighting scheme.*

885 **Risk Matrix** - the risk matrix issued with the ISDS scheduled the main risks anticipated in a street lighting PFI project. In developing the risk matrix, Brent Council identified some 59 risks, of which Brent Council anticipated that 49 would be transferred to the service provider, five would be shared, and Brent Council would retain the remainder. The risk matrix issued as part of the ISDS formed the basis of subsequent negotiations, and the negotiated position on some of the key risks is set out in the Section 3 of this Appendix.

886 Brent Council also set up a Data Room. This included the existing Inventory, data about the existing infrastructure, condition surveys and relevant plans. Brent Council warranted none of the information provided in the Data Room.

Bid Evaluation to Select Preferred Bidder

887 The three short-listed bidders were given until the middle of June 1997 to submit their First Offers in response to the ISDS. During that period, the bidders had access to Brent Council Officers and their advisors to clarify any areas of uncertainty and to discuss any emerging issues and queries. Formal technical meetings and clarification meetings were also held during this period in order to assist the three short-listed bidders develop their proposals. As part of their bid submission, the bidders were required to submit a number of Method Statements setting out their proposed approach to the key aspects of the service, such as their proposals for the Core Investment Period and working methods for design, installation, refurbishment and maintenance. A financial model setting out the proposed financing and commercial structure of the bid also had to be submitted.

- 888 Brent Council used the time whilst bids were being prepared to establish the detailed arrangements for evaluating bids once received. The technical and financial proposals that had been put forward by the bidders were evaluated against the pre-determined criteria. Establishing the risks that the different bidders were, or were not, prepared to take was an important part of the evaluation. As a result of this evaluation work, two of the bidders were invited to submit a Best and Final Offer (BaFO). Feedback was provided to the unsuccessful bidder at this stage. Some further clarification of Brent Council's requirements was required to outline clearly what was required as part of the BaFO, including what was acceptable as a variant bid.
- 889 Evaluation of the BaFO submissions during August 1997, including further technical evaluation, modelling the bidders' financial proposals, analysing the sensitivity of the bids and reviewing the taxation implications of the proposals, resulted in the selection of the Preferred Bidder in September 1997. Again, a feedback session was arranged with the unsuccessful bidder, respecting commercially confidential information and the fact that the second-placed bidder was still a reserve at this stage.

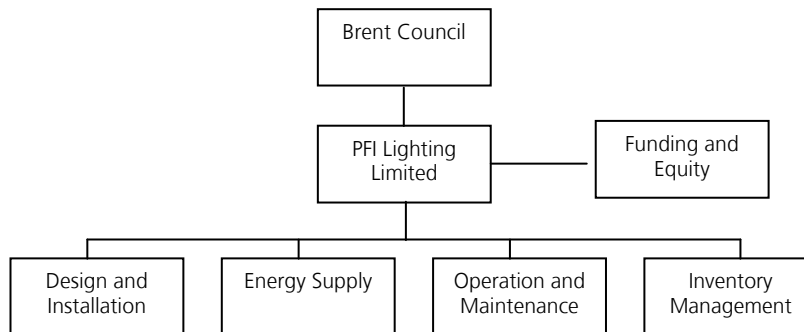
Negotiation and Due Diligence

- 890 Brent Council established a core negotiating team to take forward the negotiation of the final details of the project. External legal advisors had by this time been appointed and the advisory team provided additional support to Brent Council to take forward the final negotiations. The negotiating team reported back to the rest of the project team throughout the negotiation period. These final negotiations covered a wide range of issues, and took longer than was originally anticipated for the reasons set out earlier in this Case Study. The final negotiated position on some of the key aspects of this deal is set out in Section 3 of this Appendix.
- 891 *It is generally at this stage of the procurement process that the greatest costs are incurred and local authorities are advised to follow the guidance in Sections 7 and 8 of this Procurement Pack.*

Section 3 The PFI Contract

892 An overview of the contractual arrangements is shown in figure A3.

Figure A3 – Overview of the Contract Structure



Output Specification

893 In line with the key characteristic of PFI that it revolves around the delivery of a service not assets, Brent Council developed an Output Specification as part of the tendering process. Brent Council wanted to encourage innovation in the provision of its street lighting service and was careful not to stipulate how the service should be delivered. This is obviously difficult in a street lighting project where a key objective of the project is to replace and upgrade a number of street columns and street furniture.

894 Brent Council tackled this issue by including a Core Investment Period to address the initial backlog of problems. This covered the first five years from the Contract commencement date and is the period during which all lighting must be brought up to the required standard, appropriate to the road category being lit. This reflects the minimum programme of installation and upgrading work required. The service provider is obviously free to speed up this programme and the expectation was that this core work would be completed within three to four years. However, because of the impact on affordability, Brent Council has stipulated that payments will not be based on a replacement programme any faster than an agreed minimum period.

Performance Standards and the Payment Mechanism

895 The payment structure agreed between Brent Council and the service provider needed to establish a clear approach to relating payments to performance in delivering the service to the standards defined in the Output Specification. The key element of the payment and deduction mechanism is based on a Unitary Charge for the street lighting service; the payment is not broken down into separate infrastructure, energy and maintenance elements. The mechanism is based on the number of lights meeting defined levels and standards, as set out in the British Standard. Weighting of each category on a scale of 1 - 10 provides for the relative importance of the route and an 'Adjacency Factor' is included to take account of adjacent lights being out.

- 896 A payment deduction is made until such time as lights are replaced or converted. Only on completion of the Core Investment Programme does the full Unitary Charge become payable. In addition, there are further components to the performance and payment mechanism. These cover emergency services (such as repairing knockdowns), structural and electrical integrity, maintenance standards and ancillary services (such as quality assurance).
- 897 The performance standards are encompassed in a performance threshold – the expected level of service that can reasonably be expected. In order to satisfy the requirements of the Capital Finance Regulations in place at the time, the performance threshold equates to a percentage of the expected unitary charge, assuming that the core investment is completed in a time-scale of 3½ years. If the level of service drops below a pre-determined percentage of the performance threshold, Brent Council has the right to issue a warning notice. If a warning notice is issued in three consecutive months, Brent Council is entitled to terminate the Contract. If the level of service drops below a further pre-determined percentage in any quarter, Brent Council is entitled to terminate the Contract.

Indexation

- 898 Indexation of the Unitary Charge is fixed to three bands. There is no indexation applicable to one band, a second band is linked to the GDP Deflator, and a third band is benchmarked to increases in the energy price. The approach adopted reflects the negotiated position on the sharing of energy price and consumption risk. *The Capital Finance Regulations were changed in July 1999 to bring them in to line with the HM Treasury Standardisation of PFI Contracts guidance on indexation arrangements and local authorities are now free to use indices other than the GDP Deflator.*

Service Variations and Change Procedure

- 899 The DBFO Contract reflects Brent Council's current approach and best estimate of service requirements. However, circumstances may change over the 20-year Contract period and Brent Council needed to reserve the right to refine the Output Specification during the Contract period. Arrangements are included in the Contract to take account of service variations resulting from the adoption of new columns, new or revisions to the highway and lighting category changes.
- 900 Whilst Brent Council wants flexibility to reflect future requirements, the service provider must have certainty over what is required and the amount of funding necessary to deliver the negotiated service. Therefore, if there is new capital investment required as a result of a service variation, such as a change of lighting category, the Unitary Charge is adjusted.
- 901 If there is a general legislative change (such as new construction industry or street works requirements) and new standards are deemed to apply, these are not treated as a service variation and the service provider takes the full risk of implementing the change (not retrospective). If there is a legislative change specific to street lighting (excluding changes to the British Standard) the service provider takes the risk of implementing the change during the first five years of the Contract. Thereafter, the costs of any change are treated as a service variation and the costs of implementing the change fall to Brent Council. If there is a change to the British Standard and new standards are deemed to apply, the service provider takes the full risk of implementing future changes. If the change is deemed to be retrospective, or if Brent Council opts to apply the new standards retrospectively, Brent Council pays the costs of implementing the change.

902 Brent Council has included specific provision in its Output Specification for the introduction of lighting to school signs. If this requirement is introduced, the service provider is required to implement the change immediately and there is no service variation. *Local authorities developing street lighting PFI projects may wish to include similar specific issues in their service requirements. This could, for example, include requiring the service provider to take the full risk of minor changes in any one year to a lighting category.*

Energy Supply and Service Connections

903 As noted earlier, the service provider is responsible for all aspects of the street lighting service, including the provision of energy. The service provider has electricity supply agreements with the relevant Electricity Suppliers. It was determined that it was most cost effective to share the risk of future changes in the price and consumption of energy. *Local authorities will need to have regard to their existing arrangements for the purchase of energy in negotiating this aspect of the service. Further guidance on the issue of energy supply is included in Part 7 of this Procurement Pack.*

904 *The issue of service connections to the Electricity network remains a concern to both local authorities and the private sector. Connections currently account for a significant proportion of the total cost of installing a new column, and the absence of open competition for this work in some parts of the country is of some concern. Although this issue was satisfactorily resolved at Brent Council, local authorities developing street lighting PFI projects should ensure that appropriate Clauses are included in the Contract to ensure that the benefits of any future relaxation to the competition for connections work is appropriately dealt with. Further guidance on this issue is included in Part 7 of this Procurement Pack.*

Early Termination and Consequences of Early Termination

905 One of the major contractual areas for debate with the Brent scheme was the issue of compensation for the installed lighting stock should the Contract be terminated for any reason. Brent Council wanted to ensure that the service provider could not simply 'walk-away' and claim compensation if the Contract became difficult to deliver. The service provider wanted to recover the value of the columns installed and to avoid unjust enrichment to Brent Council. Brent Council could otherwise have obtained columns for which no, or only partial, payment had been made.

906 The Contract sets out the events of default, in relation to each party, which give the other party rights to remedy and terminate. In relation to the service provider, events of default include corrupt gifts, insolvency, breach of a material obligation, misrepresentation and performance default. Events of default in respect of Brent Council are non-payment of the Unitary Charge, breach of a major obligation and misrepresentation. There are also two events of no-fault termination covering force majeure and ultra vires.

907 If an event of default occurs, there are arrangements in place to ensure that Brent Council is not unjustly enriched or makes no windfall gain. The provisions are based on reimbursing the service provider for the value of the stock replaced, and vary depending on which party is in default and whether or not the Core Investment Period has been completed. In the event of a termination sum having to be paid, Brent Council has the right to pay that compensation either as a lump sum or over an agreed term.

908 The arrangements negotiated by Brent Council for the consequences of early termination in the event of service provider default are based on value received (less a fixed sum to reflect breakage costs). *Local authorities developing street lighting schemes should refer to the guidance on this issue in Part 7 of this Procurement Pack.*

Ownership and End-of-Term Arrangements

- 909 Throughout the life of the DBFO Contract, Brent Council retains ownership of the street lighting columns and arrangements are in place for the certificate of installation to be passed to Brent Council. However, all risk in the columns (including maintenance, painting, cleaning, lamp changes, energy, infrastructure damage, cabling and knockdowns) remains with the service provider. At the end of the Contract term, each column must have a residual life of no less than five years without further major replacement or structural repair being necessary.

Project Funding

- 910 The Brent Council project has an innovative funding solution. With no practical alternative use for the columns, the service provider ruled out a legal interest in the asset as security for the loan. Furthermore, the financing structure that the consortium proposed had minimal equity, which made the funding cheaper and hence the bid more competitive, but left only a small equity buffer to deliver the project (i.e. taking operational, business, and financial risk).
- 911 The solution was for the bank to secure the debt on the regular payment from Brent Council (cash flow lending). The lender had to satisfy themselves that the business projections were reliable and accurate (especially the installation and ongoing maintenance costs, as estimated by the street-lighting sub-Contractor). The lender obtained the comfort required by selecting an experienced and reliable sub-contractor as a partner, by passing down operational risk from the service provider to the sub-contractor (through a separate sub-contract) and by obtaining a performance bond from their partner, which can be called upon in a range of circumstances.
- 912 Brent Council received assurances about the service provider's ability to bear risk and deliver the Contract in the same way, and by carefully limiting the amount payable as compensation in the event of early termination, with a call on the two partners in all cases other than Brent Council default.
- 913 The provisions for compensation are based on reimbursing the service provider for the value of stock replaced. The formula in the Contract is varied for the different possible causes of default, the point reached in the Contract, and the number of columns installed, but in all cases the amount payable is pre-determined without reference to the bank's debt or other financing costs. In order to accept this provision the lender required a financing structure that avoids unknown funding breakage costs, and therefore a variable rate of loan interest (through an interest rate swap, with potential break costs) was discarded in favour of a capped interest rate.

TUPE

- 914 TUPE issues were not a major factor in the Contract negotiations.

Taxation

- 915 Under the Contract, the service provider takes and manages most of the risks relating to taxation. The exceptions are VAT, which Brent Council bears (regardless of any changes in the Customs and Excise relief provisions for local government), and some circumstances of early termination where a compensation payment is made and subject to corporation tax in the service provider's own tax computation.
- 916 During negotiations the question of the Inland Revenue's treatment of capital expenditure arose. The Preferred bidder took a view on this and incorporated that in the bid submission. Brent Council was keen to ensure that the service provider retained all risks on tax treatment and at the Preferred Bidder stage bidders were asked to provide assurances on the validity of the proposed treatment included within the bid.

- 917 The lender also expressed concern regarding the liability to future tax on any compensation payable on termination. This issue was discussed with Counsel. Counsel advised Brent Council that no indemnity could be given in respect of the service provider's tax liability, but payments by Brent Council could be grossed up in the event that Brent Council was required to deduct tax.

Insurance

- 918 The service provider is obliged to take out comprehensive insurance up to agreed levels. In particular, since the service provider takes the risk of loss of income due to business disruption, insurance for this risk must be carried.

Advertising

- 919 The right to advertise on the street lighting columns in Brent Council's area remains with Brent Council, subject to there being no effect on the structural integrity of the column or on the level of service provision.

Section 4

PFI and local Government Specific Issues

Capital Finance Regulations

- 920 The relaxation in the local authority Capital Finance Regulations in October 1996 enabled local authorities to take forward PFI schemes, as long as they met defined criteria set out in the Regulations. The criteria concern the general contractual features and framework of the agreement, effectively defining a Private Finance Transaction and the risk transfer criteria that must be satisfied.
- 921 A number of issues were raised during the procurement process regarding the fit of the proposed commercial and contractual structure with the requirements of the Capital Finance Regulations. Brent Council sought Counsel's opinion on a number of these issues. *There have been a number of changes to the Capital Finance Regulations since the Brent scheme was completed and local authorities procuring similar schemes will need to assess their proposed commercial and contractual structure against the requirements set out in the Capital Finance Regulations.*

Vires and Certificates

- 922 The street lighting Contract between Brent Council and the service provider is a certified Contract within the local Government (Contracts) Act and includes relevant discharge terms. Brent Council has certified that it has the powers and authority to enter into the Contract and, thereafter, perform all of its obligations in accordance with the Contract. In addition, Brent Council has confirmed that it has sufficient resources to meet its obligations in the Contract.

Public Sector Comparator

- 923 Brent Council as part of the options appraisal and business planning work developed a preliminary Public Sector Comparator (PSC), based on an initial evaluation of the inventory and the scale of investment required. This was refined during the procurement process to take account of changes in the assumptions inherent in the project. The PSC sets out the costs over the projected Contract period of the preferred solution if Brent was undertaking the scheme traditionally and included the capital cost of column replacement, maintenance and operating costs of the service. In addition, as Brent Council would have retained the project risks in a traditional procurement, Brent Council needed to include as part of the PSC its estimate of the value of the risks being transferred through the PFI Contract. The PSC enabled Brent Council to establish a benchmark against which the bids could be compared and was used at all stages of bid evaluation to assess the robustness of the bids and solutions being put forward by the bidders.
- 924 *In developing the PSC for a street lighting project, local authorities are advised to refer to the guidance in Part 2 of this Procurement Pack.*

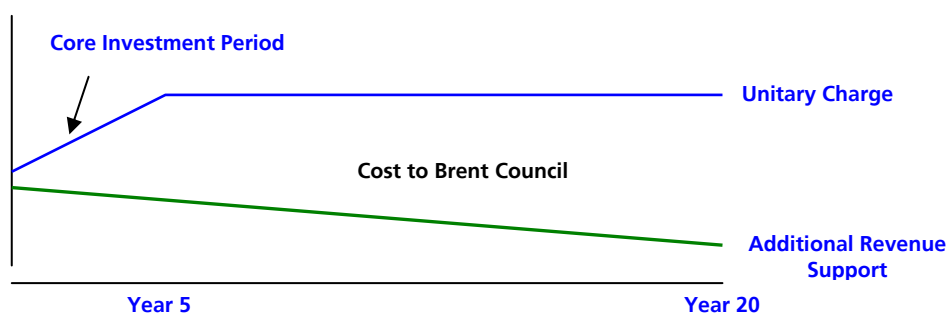
Value for Money

- 925 The main objective of all PFI schemes is to achieve Best Value in the delivery of public services. A major way in which Best Value is achieved in PFI is through the allocation of risks to the party best able to manage them, with many risks that have traditionally been taken by the public sector being transferred to the private sector. As the acronym DBFO suggests, in the Brent street lighting project the service provider will take the substance of risks in relation to designing, building (installing), financing and operating (and maintaining) the facilities required under the Contract.

Affordability and the PFI Credit

- 926 In addition to the statutory tests of value for money and risk transfer; it is also necessary to ensure that the cost of any PFI Contract is affordable to the procuring body over the life of the Contract. Brent Council kept Members informed of the likely cost of the scheme to Brent Council throughout the procurement process and at all key stages sought Member approval of the affordability of the project. *For street lighting schemes, the cost of the project to the local authority will reflect the gap between the existing budget provision, any additional revenue support and the Unitary Charge for the service.*
- 927 Local authorities are able to seek revenue support for their PFI schemes towards the 'capital element' of the scheme. Brent Council has received a PFI Credit of some £8 million towards the total costs of the street lighting project. This reflects the NPV of the capital investment during the Core Investment Period. *Local authorities need to be aware that revenue support for PFI projects reduces over the period of the Contract (see guidance produced by the 4ps project support team on The Outline Business Case).* The graph in figure A4 demonstrates the affordability gap of the Brent street lighting project that has to be met from existing resources.

Figure A4 – Project Cash-flows (not to scale)



Risk Allocation

- 928 The preliminary risk allocation for the Brent Council scheme was disclosed in the ISDS and formed the basis of much of the subsequent negotiations.
- 929 The Capital Finance Regulations in place at the time required there to be sufficient variability in the payment to be made by Brent Council to the service provider for there to be a possibility of at least 20% reduction in the payments to the service provider, without the Contract being terminated for default. The risk transfer test was intended to ensure that payments by Brent Council to the service provider are variable, depending on the performance in delivering the services required, and that there is significant transfer of operating and performance risk to the private sector.
- 930 To satisfy the risk transfer test, Brent Council set a performance threshold below the 80% level. Payments can drop to this level as a result of failure to perform on any of the performance standards. If performance falls to this level, the local authority has the option to terminate the Contract or to adopt a modified performance regime. The payment mechanism uses the established principles to pass the risk transfer test (no service equals no fee), and furthermore intermediate steps are used in the 74-80% payment range to try to correct serious problems before a final termination occurs.

931 *The DCLG has subsequently amended the risk transfer test and the risk transfer test is now based on the accounting requirements of Financial Reporting Standard 5 (FRS5). Local authorities developing street lighting projects will need to ensure that the project is appropriately structured to be off balance sheet in accordance with the requirements of FRS5.*