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The Payment Mechanism Paper should be included as part of the Instructions and Guidance to Bidders issued as part of the ISDS.

The aim of a Payment Mechanism Paper should be to set out in a clear and succinct way the key principles and components of the payment mechanism, effectively to provide a non-legalistic outline of the payment mechanism proposals. The Payment Mechanism Paper must support the contractual requirements for the payment mechanism included in the Model Contract (Model 8 – Payment Mechanism Schedule) but aim to explain the Authority's proposals and intentions in a less formalistic and legalistic way.

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The Payment Mechanism

This Section of the 'Instructions and Guidance to Bidders' sets out the basis of calculation for the payment to the Service Provider for the provision of the street lighting services covered by this project, and should be read in conjunction with the Output Specification and the Contract terms for the payment mechanism (Schedule 8). The payment mechanism determines the payments that the Authority will make to the Service Provider and establishes the mechanism for the Service Provider to deliver the services required in a way that demonstrates Best Value. Other than where explicitly stated in the Contract, the payment mechanism is intended to form the sole basis of payment to the Service Provider.

The Authority will agree the final form of the payment mechanism during dialogue with the Bidders. However, the Authority is unlikely, without good reason, to move from the principles set out in this paper.

Aims and Objectives

The objectives of the payment mechanism are to:

- Set out how the Service Provider can achieve the maximum possible Monthly Unitary Charge over the life of the Contract by achieving the performance standards set out in the Output Specification
- Define the Unitary Charge, Monthly Unitary Charge and electricity payment
- Provide incentives for the Service Provider to meet the performance standards by placing the Unitary Charge at risk for failure to meet those standards
- Provide incentives for the Service Provider to correct any failures as rapidly as possible and to avoid repeated failures by the use of rectification periods and escalation of deductions
- Match payments to outputs by increasing the Monthly Unitary Charge to reflect the introduction of new street lighting Apparatus to the Authority network and the corresponding Relevant Standards
- Set out clearly the contractual obligations of the Authority and the Service Provider as far as the Unitary Charge and payment deductions are concerned
- Provide an incentive for the Service Provider to innovate and secure efficiency gains over the life of the Contract
- Set out how variations to the service are to be paid for in respect of Accruals/De-Accruals
- Assist the Authority to meet its strategic objectives, Best Value and reporting obligations

Concepts

The payment mechanism is based on a single Unitary Charge plus payments for energy payable in monthly instalments. The Unitary Charge is subject to a series of performance standards and performance targets against which the performance of the Service Provider will be judged, with adjustments being made from the Unitary Charge if those standards are not attained.

The performance standards, performance targets and the methods for monitoring performance are set out in the Output Specification. The period, over which performance will be assessed against the standards, and for which adjustments shall be made, will be a calendar month.

The Service Provider is required to measure its own performance under the contract and report monthly to the Authority. The Authority has rights under the Model Contract to check the accuracy of the measurement and reporting carried out by the Service Provider.

To accommodate the objectives of the payment mechanism, in parts the formulae used to calculate payment adjustments include a multiplier, the aim of which is to generate proportionately greater adjustments for persistent sub-standard performance to reflect the proportionately greater costs to the Authority of managing such sub-standard performance.

In addition to the Unitary Charge there is a payment in respect of electricity – the ‘Electricity Cost Adjustment’. The principle of this payment is that the Authority is subject to price risk and the Service Provider is subject to consumption risk. This recognises that the Authority is best placed to manage the risk of variations in energy prices over the contract term. It also provides incentives for bidders to bid back efficient electricity consumption profiles and for the Service Provider to manage electricity consumption efficiently as possible.

Operation of the Payment Mechanism

The Unitary Charge is the payment that would be made if all the performance standards were fully complied with. In submitting Bids, Bidders should note that they must assume that there are no deductions under Performance Standards 2 to 8, i.e. the Unitary Charge that the Bidder should assume they will receive is only subject to an adjustment in relation to Performance Standard 1 and there will be no adjustments made once the Core Investment Programme is complete. The Monthly Unitary Charge will be one twelfth of the Unitary Charge except for in part months where it will be determined by the number of days the service is to be provided in that month.

If the payment mechanism generates total deductions (excluding deductions levied under Performance Standard 1) in excess of [25%] of the Monthly Unitary Charge in any one month then a Service Default Termination Point shall be awarded to the Service Provider. If the payment mechanism generates total deductions (excluding deductions levied under Performance Standard 1) in excess of [20%] of the Monthly Unitary Charge over a period of 3 consecutive months then a Service Default Termination Point shall be awarded to the Service Provider. Where the Service Provider has accrued 3 or more Service Default Termination Points in any 13 month period the Authority may terminate the Contract.

Full details of the invoicing and payment arrangements can be found in Clause [26] of the Model Contract. The arrangements are based around a process where the Service Provider invoices for the Unitary Charge for one month less any adjustments related to the previous month. The Authority is required to pay that part of the invoice that is not disputed within 20

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Business Days of receipt. Authorities may wish to adjust the payment terms to fit in with their standard invoicing procedure or to reduce the payment period if it believes it would offer better value for money.

Performance Standard 1 - Lighting Installation (PS1)

PS1 covers the lighting installation and provides a sculpting methodology within the payment mechanism to ensure that the Service Provider is only paid for street lighting Apparatus that meets the Relevant Standards as set out in the Output Specification. In addition to this payment incentive to progress the Core Investment Programme the Model Contract includes a series of milestones that must be met by the Service Provider during the Core Investment Period.

The Model Contract sets out the arrangements for the commissioning of new or replacement Apparatus. A PS1 deduction will apply to each item of Apparatus that fails to meet the Relevant Standards specified in the Output Specification during each period. Certificates of Compliance will be issued on a group basis (normally by street) as items are brought into compliance. Such certificates will only be issued when the work has been undertaken in accordance with the Output Specification, Method Statements and the relevant standards.

For affordability reasons the Unitary Charge is subject to a non-acceleration clause relating to the contractors progress with regards to PS1. The non-acceleration clause also relates to the forecast energy consumption profile.

Bidders should note that a Milestone Default Termination Point will be awarded if the Service Provider falls behind programme to a level considered excessive by the Authority. Three such points will give the Authority the right to terminate the Contract. If the Service Provider returns to programme then these points are cancelled. Detailed drafting on the award of such points is contained in Clause 12 of the Model Contract.

As a result of the award process for Milestone Default Termination Points, failure to achieve 100% compliance by the end of [year six] of the Contract (the CIP being expected to run through to the end of year five) would give the Authority the right to terminate the Contract.

Optional drafting is available if the Authority wishes to treat other CIP Apparatus, such as Illuminated Traffic Signs, separately from Lighting Columns. The multiplier for Other CIP Apparatus should be determined on a project specific basis and should be based upon the capital value associated with the different categories of CIP Apparatus.

Performance Standard 2 – Lighting Performance and Planned Maintenance (PS2)

This performance standard measure:

- The number of units in light
- The quality of lighting delivered
- The regimes in place to periodically measure, test, inspect and clean the Apparatus

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The Output Specification sets out the service delivery requirements for each of these measures and the performance targets that the Service Provider is expected to meet. Performance against the targets set out in the Output Specification will be measured through a range of systems, including:

- The measurement of street lighting units in light, either from a visual inspection or other relevant monitoring process of each unit
- The photometric testing of the delivered light output, which is to be performed on a sample basis
- The planned maintenance arrangements in place for the Apparatus.

The operation of the measure of the percentage of lights in light is dependent on a regular monitoring regime. To enable the operation of the adjustment, Bidders are required to propose a monitoring regime. This outage detection system should as a minimum, check the performance of each column on an equal number of occasions at least once per month and in accordance with a regular pre-defined programme. The Authority should have the opportunity to take part in or 'shadow' the monitoring regime. The Authority has the right to terminate the Contract for Service Provider default once the percentage of lights in light falls below [93%].

The quality of light output will be tested on a sample basis in order to generate a percentage of lights meeting the designed light output. The adjustment is designed to increase in significance as the quality of light deteriorates. The Authority has the right to terminate the Contract for Service Provider default once the percentage of lights meeting the designed light output falls below [50%].

The planned maintenance arrangements will be reviewed by assessing the number of failures to carry out planned maintenance work in a specific month. The total number of failures will be multiplied by a standard adjustment value to calculate the total adjustment due. Specific parts of the planned maintenance arrangements will also generate an adjustment based on the number of days before the planned work is eventually carried out.

[Insert any project specific details of measurement periods, any sampling arrangements and how the results of any sampling will be extrapolated]

The deduction regime under PS2 is designed to incentivise the Service Provider to provide the standards of service set out in the Output Specification and deductions escalate for lower levels of attainment to reflect the risks and costs of service failures.

Performance Standard 3 – Operational Responsiveness and Reactive Maintenance (PS3)

PS3 covers the Service Provider's arrangements for dealing with emergency and non-emergency faults.

The Output Specification includes a performance target to attend and to commence and continue works to make safe any emergencies within [one hour] of the emergency event being reported or coming to the Service Provider's attention. If this performance target is not met, then a deduction will be made in accordance with the payment mechanism.

The Output Specification includes a requirement for a maximum time, measured in Working Days, during which a range of non-emergency faults may remain uncorrected. If these performance targets are not met, then a deduction will be made in accordance with the

payment mechanism. The length of time that the Service Provider has to correct a non-emergency fault is dependent on the type of fault with specific detail being provided in the Output Specification.

The payment mechanism includes a multiplier. This is intended to motivate the Service Provider to avoid lengthy periods during which equipment is left in an unsafe or unsatisfactory condition or out of service and to reflect the increasing costs to the Authority of such a situation.

Performance Standard 4 – Contract Management and Customer Interface (PS4)

The Output Specification sets out a number of requirements for liaison with, and information to be provided to the public and the Authority, as well as the retention of records and maintenance of accurate management information. The Output Specification also sets out maximum times for a response to be given in various circumstances.

A performance target deals with the requirement to maintain and update the Management Information System. There is a measurement of the accuracy of the Management Information System, which is first tested following Service Commencement Date in respect of [changes/updates carried out by the Service Provider] and in the second year following Service Commencement Date in respect of [all data on the system]. This allows the Service Provider to complete the survey work required to produce an accurate and complete Management Information System. A target is included for subsequent updating. Once the Management Information System is at the required level of accuracy, then the accuracy and timeliness of updates to the Management Information System are measured. Accuracy of the Management Information System is defined as the number of accurate entries divided by the total number of entries that should have been on the system at the time of measurement.

The Service Provider will be required to produce auditable reports in respect of updates carried out each month showing how many failure events occurred and how many were dealt with within the time limit, and how many were not. A deduction is applied for each failure to achieve the response time and is also subject to a multiplier dependent on the severity of the failure.

The Output Specification also requires a Customer Care System to be implemented and be capable of being accessed at all times. To the extent that the system is unavailable, a deduction will be made based on the percentage of availability during each month.

The Service Provider is required to communicate with the general public and respond to queries from all parties in a reasonable time. Any failure to achieve the required service standards can result in a deduction. The Service Provider will be required to report each month on its performance in answering phone calls within [5 rings] and will be subject to a deduction depending on the percentage answered in the target timeframe. With respect to other communications a deduction is applied for each failure to achieve the response time. If there is a failure to rectify within a further [5] Business Days a further deduction will apply. For each subsequent period of [5] Business Days during which the failure remains un-rectified, a further deduction is made.

All deductions under PS4 are totalled and this forms the PS4 deduction for the month.

Performance Standard 5 – Strategic Assistance and Reporting (PS5)

The Service Provider is required to co-operate with the Authority in its efforts to meet the requirements of Best Value, the Comprehensive Performance Assessment and for producing the Local Transport Plan. These requirements focus on 'Strategic Assistance and Reporting' and the strategic assistance and reporting obligations on the Service Provider are set out in the Output Specification. In summary, these cover the following:

[Authority to insert details as appropriate to cover their specific requirements]

The Service Provider's performance shall be measured on its ability to produce and deliver specific information and reports in accordance with the timetable set out in the Output Specification.

There are deductions for not providing the assistance and reports in accordance with the Output Specification *[and Method Statement • – Strategic Assistance and Reporting]*. These are based on a monetary value dependent on the importance of the information to the Authority and the impact not receiving the information has on the Authority's ability to meet its obligations.

Where the Service Provider continues to fail to meet its performance obligations the adjustments will be doubled for each additional month of failure until the required information or the required task is completed.

Performance Standard 6 - Working Practices (PS6)

The Output Specification sets out a number of requirements with which the Service Provider must comply. The performance targets include [but need not be limited to] the following areas:

- Working methods
- Notices under NRSWA
- Health and Safety and Site Security
- Waste Disposal and COSHH
- Quality Assurance
- Working Hours and Nuisance
- Protestor Action
- Access
- Service Provider Personnel
- Department of Personnel
- Corporate Identification
- Service for Third Parties and Recovery of Debts
- Festive Lighting

Failures under each of the performance targets are categorised as Routine, Serious and Urgent with appropriate response and rectification times for each category of fault. Where the appropriate response and rectification time is not met the following adjustments are made:

- Urgent – [£10,000] per failure
- Serious - [£5,000] per failure
- Routine – 5 performance points per failure, with an adjustment of £50 per point for each point over 25 awarded in any month

Performance Standard 7 – Reporting to the Authority (PS7)

The Service Provider is required to accurately monitor and report contract performance on a monthly basis. Where this does not take place PS7 provides for adjustments to be made based on the extent of the failure.

Where any failure occurs in a month a one off adjustment of [£50] is made. A correction shall be made for each individual failure and an additional adjustment equal to 50% of the error can be made to reduce the Monthly Payment.

Performance Standard 8 – Post CIP Lighting Installation (PS8)

PS8 is only applicable if it is proposed that lighting is installed following the CIP, i.e. after the end of year 5. The Authority should note that PFI Credits are calculated based on the capital expenditure during the CIP only.

The Output Specification sets out the performance targets in place with regards to lighting installed following the CIP. Where the Service Provider fails to complete the required level of work as set out in the Annual Investment Programme for any specific year a deduction can be made based on the number of roads on which the work has not been completed.

This performance standard is tested on an annual basis, in the first month after the end of a payment year, rather than monthly in line with all other performance standards.

Electricity Payments

As noted above, the Unitary Charge excludes payment in respect of electricity. The payment of electricity is covered by the Electricity Cost Adjustment (ECA), and is calculated in order to ensure that the Authority is subject to price risk and the Service Provider is subject to consumption risk. If actual electricity consumption is less than forecast then the first 5% of savings are retained by the Service Provider. Savings above 5% are shared equally between the Service Provider and the Authority.

The Payment Mechanism also includes provision to ensure that if the Service Provider does not carry out the CIP as forecast the Authority is not subject to any additional electricity payment as a result.

For the purposes of the bid to ensure consistency in evaluation, bidders are asked to assume a unit cost for electricity of [x] pence/KwH indexed on the 1 April each year at [2.5%] per annum.

The Authority reserves the right to procure electricity itself or require the Service Provider to do so during the contract term. The key determining factor will be which party can procure at the lowest price. As part of the ISDS submissions the Authority will seek confirmation of the prices that the bidders can procure at initially upon service commencement to inform this decision.

It should be noted that Authorities are often able to procure on more favourable terms than bidders due to their bulk purchasing power often due to membership of regional purchasing consortia.

The Payment Mechanism is designed to ensure the correct payment is made under either scenario. If the Authority decides that the Service Provider should enter into the electricity contract it should consider if the current electricity supply contract can be terminated or novated to the Service Provider.]

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The electricity price will be subject to market testing every [2] years in accordance with Schedule 9 of the Model Contract. However, the Authority can at any time elect to carry out the market test of energy or to enter into a contract for energy itself.

The Authority may request from time to time a change to the current lighting regime. This will require the Service Provider to calculate an Alternative Forecast Consumption for each Electricity Tariff Band.

The drafting provided regarding the Alternative Forecast Consumption assumes Parties agree to calculate a forecast impact of change to the current lighting regime prior to implementation of the change.

Until the use of remote monitoring technologies has been agreed as an acceptable method for calculating electricity charges the method of measurement will need to be agreed between Parties prior to entering into the Contract.

In the event that the change in lighting regime results in a breach of terms of the current electricity contract the Parties will consider the extent of additional costs and may agree to carry out an Electricity Market Test.

Annual Review of the Unitary Charge and Energy Payment

The Unitary Charge will be reviewed each year with a view to ensuring that the payments reflect the changes in the value of money and the changing costs of providing the type of services covered by the Contract. Reviews will take place in the context of the Authority's Best Value responsibilities.

For this purpose the cost of electricity consumed is inflated separately from the rest of the Unitary Charge and is based upon the actual price (pence/KwH) procured by the Authority or Service Provider. The Unitary Charge excluding electricity cost is inflated by a percentage of RPIX. Bidders should bid a percentage factor by which RPIX is to be multiplied in order to calculate the uplift percentage.¹

For bidding purposes, RPIX should be assumed to increase at [2.50%] per annum.

As an example, if the bid factor were 30% and RPIX 2.50% then the Unitary Charge uplift factor would be 0.75% ($30\% \times 2.50\% = 0.75\%$).

Other sums within the Model Contract, which are expressed as 'Indexed', are re-calculated annually in accordance with the change in RPIX over the preceding year.

Potential changes or variations to the service

The Model Contract (Clauses 23 and 24) sets out the specific arrangements for dealing with potential changes or variations to the service.

¹ Authorities may wish to specify a percentage for RPIX to be multiplied by rather than allowing bidders to propose a figure.

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As noted in the Model Contract, where the Authority from time to time exercises its option to increase or decrease the Apparatus to be included in the service, it is the Authority's intention to deal with a number of these changes through the payment mechanism and the Unitary Charge will be re-calculated to reflect the increased or decreased costs to be incurred by the Service Provider.

Bidders are required to bid values for each category of Apparatus as set out in paragraph 4.1 of the payment mechanism to be used when accruing or de-accruing Apparatus.

Where any capital expenditure is required in relation to the Apparatus to be accrued to be de-accrued from the service such expenditure is dealt with as an Authority Change under Schedule 7A of the Model Contract and such Apparatus are not accrued or de-accrued in accordance with the payment mechanism.

Whenever an Accrual or De-Accrual takes place, the forecast electricity consumption is adjusted to take account of the expected change in Kwh.

It should also be noted that the payment mechanism adjustment is not applied if the actual numbers of Apparatus is found to be different from the number shown in the current inventory and/or incorporated into the Bid. It is for bidders to satisfy themselves of the number and type of Apparatus to be included in their Bid.

The scope of the net increase or decrease in the total number of Apparatus to which the Service Provider is providing the service is limited to [5%] and [2%] respectively, before the financial impact of any quantity variation will be calculated through the Authority Change process rather than the payment mechanism.

It is noted that post contract signature that there may be technological advances in Apparatus that may significantly reduce electricity consumption. These changes in Apparatus from the Service Providers' Method Statements are to be agreed through the Change procedures and the forecast electricity consumption profile will be re-based so that the Authority retains the benefit of reduced electricity consumption due to technological advances.