

***Defence Procurement
Agency***



***Partnering & Private
Finance Initiative***

Preferred bidder negotiations on DPA PFI projects

<u>Author:</u> Frank Patalong, CSG-PPFI-LAW	Contact Details: Tel: 0117 913 4269 Email: CSG-PPFI-LAW-RDAWN
<u>Internal Approval:</u> Cameron Stewart, Head of CSG-PPFI	

Objective

1. The objective of this Guidance Note is to:
 - prompt IPTs into efficiently preparing for and managing the preferred bidder stage of the procurement process on DPA PFI projects; and
 - provide IPTs with information on the likely processes to completion of their projects so that they can plan how to manage this stage of the procurement.

Context

2. This Guidance Note is aimed at DPA PFI projects which are in the preferred bidder stage of their procurement. Many of the points it raises are dependent on actions taken during the competitive stage of the procurement process (i.e. prior to appointment of the preferred bidder) and this Guidance Note should be read with **DPA PFI Guidance Note on Drafting PFI Contracts** especially if that guidance has not been previously consulted by the IPT. IPTs must also have read and satisfied the tests set out in the **DPA PFI Guidance Note on Selection of the Preferred Bidder** (see paragraph 45 below) and consulted **Treasury Taskforce Technical Note No.4 (How to appoint and work with a preferred bidder)**. Despite that earlier guidance there are still a number of projects which enter the preferred bidder stage without the required level of certainty on key issues. Rather than assume that the earlier guidance has been completely adhered to, this note looks at situations where (for whatever reason) the IPT finds itself exposed to a variety of common pitfalls. It assumes that the IPT has conferred preferred bidder status (or is imminently to do so) and looks at the next steps under three broad headings:

- What happens during the Preferred bidder stage;
- Common Pitfalls during the Preferred bidder Stage; and
- Loss of Competitive Tension and Uncompetitive Re-pricing

What happens during the Preferred bidder Stage

3. Once an IPT has selected its preferred bidder the endgame of the procurement process begins in earnest. There are three main players involved during this stage – the Authority, the preferred bidder and the lenders. Each of these players will have separate technical, financial, insurance and legal advisers. Aside from the three main players and their advisers there are a range of other interested parties who must also be kept in the loop on progress (and may ultimately be involved in any final approval process or require consultation) – the Treasury, the NAO, customers, DPA PPFi and unions. In order to satisfy the sometimes competing needs of all these parties it is therefore vital that the IPT grips and understands the processes involved from the outset. There is a logical order to events which is in large measure determined by the lenders' requirements.

4. The IPT cannot manage this process alone but it should play a key role in orchestrating the combined activity of the main players. Appendix 1 sets out an indicative time line of the key outputs and processes that need to be achieved in order to achieve contract award. This time line assumes that there will be no funding competition (the majority of projects so far completed have not involved funding competitions although this may change on certain commoditised accommodation or well understood equipment projects in future) and that bank as opposed to bond finance will be raised. It looks at what activities need to be undertaken and in what order. The time line is not however a prescription. Each IPT will need to scope and develop its own equivalent in conjunction with its advisers and the other main players as early in the process as possible – perhaps generating a gantt chart using

appropriate project-planning software. The reader of this guidance may, however, find it useful to have Appendix 1 to hand whilst reading the text.

5. The preferred bidder stage can be broken down into four broad steps:

- consolidation of the deal and documentation developed with the preferred bidder;
- evaluation and due diligence on that deal and documentation by the lenders;
- negotiation on points raised by the lenders leading to commercial close with all parties; and
- financial close.

6. Elements of the first two steps will probably overlap, but the more the IPT and its preferred bidder have agreed prior to lender involvement, the better.

7. The IPT is more likely to be exposed to an extended preferred bidder stage and uncompetitive re-pricing if it has inadequately managed the process leading to appointment of preferred bidder. No IPT will get everything right all of the time but most could manage the process better. The following section details key flaws that are common to many teams at this stage of a procurement. They are not set out in order of importance and will often overlap. The number of such flaws that become apparent is a fairly accurate indicator of the likely length and difficulty of the negotiation ahead.

Common Pitfalls during the Preferred Stage

Fail to prepare – prepare to fail

8. The preferred bidder stage of the process is (even with preparation) by far the most demanding, stressful and time consuming phase of the project – and the challenge will be further exacerbated by an IPT's failure to prepare. Every IPT approaching this phase needs to take a long, critical look at how the procurement has been run thus far and think about how things could be improved in the next stage. The following questions should (in no particular order) be posed:

- Have we met project milestones so far and if not what caused the slippage in the timetable?
- If we have met project milestones so far has this been achieved at the expense of optimising competitive tension? What do our external advisers think?
- Does our internal customer have a realistic view of the timetable to completion?
- Do we have the right number of the right people with the right skill-set in our IPT?
- Are we about to lose any key personnel from the IPT?
- Have we identified all key outstanding issues?
- Have we identified all issues that are likely to exercise the lenders in their due diligence and which may in consequence cause issues agreed with the preferred bidder to be re-opened?
- Are we confident that the preferred bidder's lenders' acceptance of positions during the competitive stage was based on a robust understanding of the risks?

- Are those issues listed in a format that is readily accessible by IPT members?
- Is there an agreed “hymn sheet” for negotiating each of these issues (see paragraph 30 below)?
- Have we considered methods of incentivising advisers to achieve contract award in a timely manner?
- Have we looked all available guidance and consulted in detail on our strategy with the PPF?

In looking at these questions some IPTs have elected to have an away-day(days) to facilitate discussion. This approach often produces excellent results particularly where advisers have been given the opportunity to contribute. Time scoping the time table has paid dividends later in the process. The use of lists and “hymn sheets” is explored in more detail below (paragraph 30).

Be clear on the basis of appointment

9. In appointing a preferred bidder the IPT should be very clear in terms of its expectations for the next stage of the procurement. Best practice dictates that the preferred bidder (either in its letter of appointment as such or shortly thereafter) is given a closed list of issues which remain open for negotiation (based on the evaluation of its bid and any subsequent clarifications) and is required to agree such list prior to any further discussion. If the preferred bidder adds issues to the list the IPT needs to take a view on their materiality and decide whether it still wishes to pursue negotiations with this bidder. If the issues which are added are materially different to what the IPT understood to be the position in the bidder’s last competitive submission then query whether the IPT should actually revisit its evaluation of bids. The net effect of this process is that *outstanding issues are scoped in detail prior*

to being negotiated. In effect, the IPT is given a final opportunity to take advantage of competitive tension. The aim in scoping the remaining issues for resolution is, as far possible, to narrow the issues open for discussion and impose some discipline on the process. To facilitate this scoping activity IPTs should issue a fresh version of the documentation capturing all agreed points and identifying those where further discussion is permissible. Lenders will also want to have input on the list of outstanding issues. Ideally the IPT will want to identify a realistic contract award date with the preferred bidder and lenders, but can only do so if it has comprehensively scoped the activity leading to project closure. It may also wish to discuss with its advisers (having regard to the relevant framework agreement) whether there is an appropriate mechanism under which they can be incentivised regarding their input during this stage of the procurement process.

10. It is important that lenders make a good start to their due diligence activity (and in particular their technical due diligence). The IPT must factor into its time-tabling the availability (or not) of the lenders' advisers and in particular, on complex equipment projects, the technical advisers. Availability considerations can have a significant impact on the time-table. If the IPT is required to indicate a level of confidence that such and such a date is achievable, and does so without analysing dependencies on external advisers it runs a very real risk of over-optimism. An over ambitious long stop date may even prejudice the IPT's negotiating position if the other parties decide to leverage additional concessions by manipulating the process to their advantage.

11. If the IPT knows that there is a possibility of the bidder's price validity lapsing during the next stage of the procurement it must take steps at appointment of the preferred bidder to address this issue and settle the basis on which any amendment will be made together with a methodology for assessing its impact on the project's overall affordability (more on this at paragraph 49 below).

12. Having a list of outstanding issues is – by itself – not sufficient. The Authority should further attempt to limit the scope of discussion on these issues. For example, if the proposed preferred bidder raises concerns about the level of indemnity that it is required to provide and its particular concern (as advanced in its bid) is say third party liability, then the issue that remains open for discussion is precisely that and not indemnities on a wider basis. The more detailed the list the better.

13. Scoping outstanding issues requires time and preparation. The output of the bid evaluation will produce a recommendation of preferred bidder. But it should also identify the areas of dissonance between the Authority's position and that of its preferred bidder that remain to be resolved – in that sense the Authority's preparation for the preferred bidder stage begins with the evaluation of bids at ITN or BAFO. All of the work that an IPT does at ITN and BAFO lays the ground work for this stage. IPTs that fail to capitalise on this ground work and view the preferred bidder stage as somehow “new” have missed the rationale behind using a competitive process.

14. The IPT must also decide when to de-brief the other bidder(s). It may wish to consider running a “reserve bidder” in which case the de-briefs can only occur once it has firmly settled on a deal with the preferred bidder and that deal has been approved as bankable by the lenders (probably after contract award). Running a reserve bidder is dependent on the willingness of that bidder to maintain a bid team. It will be unlikely to do so if it considers that the IPT is not running a tight ship in terms of the way of the procurement has been run to date. If the IPT has engendered confidence in its running of the process across its bidding community then it stands a better chance of having a credible reserve bidder.

Get the Specification Right

15. There can be no substitute for a clear output specification which is:

- capable of being priced by bidders;
- dovetails seamlessly with the payment and performance regime; and
- has captured all key stakeholders' requirements during the competitive phase of the procurement.

On some projects where the output specification has not been adequately worded and does not read across into the other key documents IPTs have found themselves in the position of having bidders who have priced their service solution (because it is more certain) as opposed to the Authority's output specification. This risk should have been addressed long before down-selection. In the unlikely event that IPTs do find themselves in this position (for whatever reason) with a preferred bidder they must immediately contact the PPFi who will assist.

16. Any ambivalence in the output specification will be picked out by the preferred bidder and the lenders' technical advisers during the non-competitive stage and will cause delay, confusion and probably re-pricing. The preferred bidder stage is far too late in the process to be correcting errors in this key element of the project documentation. That said, some IPTs have taken the opportunity of "polishing" their output specification and supplying a "refined" document to the preferred bidder on appointment – this approach is acceptable if what is being done is purely ironing out ambivalence but may prove more problematic if the IPT is attempting to correct its own errors or add additional requirement. If the latter is the case then be prepared for a request to re-price in which case the advice in paragraphs 44 to 54 is relevant. IPTs should also take legal advice on the materiality of any changes to the output specification and the likelihood of challenge from a down-selected bidder.

17. An all too common failing of IPTs is that when they begin drafting the various documents that will comprise their concession agreement they approach the task through "silos" and often fail to integrate the various

documents. This often comes to light comparatively late in the day and is especially difficult to fix once competitive tension has been lost. It is absolutely critical that the output specification, the payment and performance mechanism and the contract read as (and are developed as) a single document. For a discussion on the importance of drafting project documents outside “silos” see the DPA PFI Guidance Note: Drafting PFI Contracts.

Have a Direct Relationship with the Lenders

18. The IPT should have independent lines of communication to the lenders so that it can satisfy itself:

- that key elements of the funding deal meet its requirements; and
- that there are no mixed messages in terms of what the lenders’ requirements are.

19. If the IPT has cultivated a relationship with its preferred bidder such that both parties are presenting a united front to the lenders as “co-sponsors” (see paragraph 45 below) then this interface will be less of a concern. However, it is not uncommon for a preferred bidder to use its lender as a kind of umpire on risk allocation/cost issues in which case the IPT needs to have access to the relevant people at the lender in order to test any assertions about “bankability” made by the preferred bidder.

Be clear about roles in your negotiation team

20. Small, focussed and empowered negotiation teams work best. Before you enter into negotiations with the preferred bidder you must establish a clear demarcation of responsibility within the negotiation team and clear reporting lines to those ultimately involved in the approval process. It may be that you assign one person responsibility as “lead” negotiator (normally the IPT Leader) who will set out positions of principle and respond in kind,

another as “right hand” who will ask questions and test assumptions (sometimes a role picked up by an external adviser although ideally the “right hand” should be an Authority individual who can step into the breach if needs be) and a third as secretary to record what has been agreed (more of which below). The key message is to settle on a *modus operandi* which plays to the strengths of your team (and those of your advisers) and which is consistent – letting lenders and preferred bidder know exactly who they should be addressing and thereby minimising the risk of mixed messages being transmitted in return. It is also useful to have an identified champion at executive director level who can step in if particularly problematic issues arise. To do so however requires a good communication and briefing strategy so that the director is fully in command of the relevant detail if called upon to assist. The IPT should, in any case, establish sensible reporting lines to ensure that there are no surprises for top level stakeholders involved in the approval process. Before involving anyone at director level the IPT should have exhausted all support groups (including PPFI) and perhaps the relevant section of the National Audit Office in an attempt to determine a satisfactory Authority position.

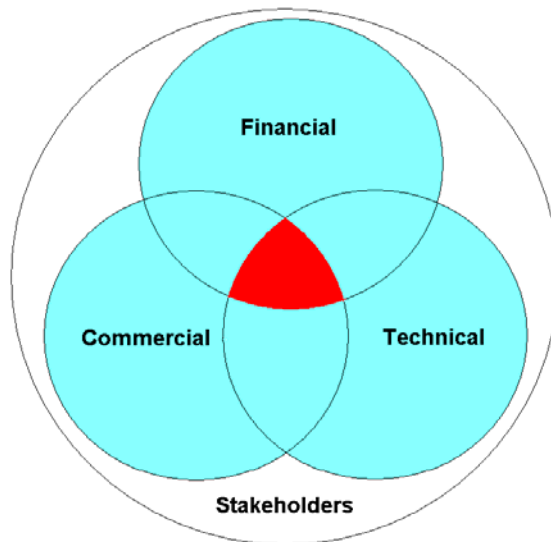
21. Meetings (more of which below) can, if not carefully managed, become unwieldy, unproductive and frustrating. Often, the best way to ensure that a meeting achieves its aims is to keep numbers down to the minimum required and the best way of establishing what the minimum number should be is to have analysed and planned what peoples’ roles are well in advance. There really should only be three or four people on the IPT’s side (including advisers) who are empowered to speak (uninvited) at any meeting and, even then, there should be one person tasked to deliver key messages. If that person is not available on any given day (and this will happen) then the team should identify whoever has picked up that role and confirm that the leader has delegated his authority accordingly (or confirm on what other basis the meeting can go forward). Team members must (where possible) commit to the project for the duration of the preferred bidder stage. If your IPT is at risk from losing key people during this stage you must plan for and manage the succession process. During your initial scoping activity the IPT should also

spend some time analysing the skill-set required for the next stage allocate tasks according the team's strengths (more on this in paragraph 38).

Lists

22. Perhaps the key indicator that you are managing the preferred bidder process well is the proliferation of lists that should emerge at this stage. *Everything that is outstanding needs to be written down and worked through methodically.* As already stated, the IPT should be clear on the basis of appointment of the preferred bidder – part of which includes the provision of a list of its outstanding issues. The preferred bidder should be asked to accept that list or add to it in its response to the appointment letter. As issues are discussed the initial list will expand and when lenders become heavily involved may expand significantly. This is normal. The key is having a strategy for dealing with the issues on the list.

23. Issues can be allocated generically according to subject matter. They may be technical, financial, commercial/legal or partnering issues. They will more than likely overlap and those tasked with taking forward their resolution need to be mindful that resolving a given issue in a “silo” is not likely to have achieved resolution at all. The graphic below represents the key interfaces that will be of concern to the IPT and the other main players – an issue can only be deemed fully resolved if the individuals at the centre of these overlapping circles (on all sides) have reached agreement. Paragraph 53, for example, looks at the pivotal importance of the financial model and key assumptions in negotiations – it is clear from the graphic below that work done on the model needs to be understood in the context of the commercial and technical spheres of the project.



24. Issues should be ranked in order of importance to the IPT and in order of importance to the preferred bidder and (if possible) in order of importance to lenders. Clearly, it is difficult for the IPT to guess with absolute accuracy the relative importance of issues to the other parties - but with good external advice and the application of some common-sense it should be able to have a reasonable stab at this. The key thing is to put yourself in the shoes of the other parties and imagine what their constraints and commercial drivers are likely to be – they will certainly have analysed the Authority’s position on this basis and will, for example, use any “drop dead date” which has been disclosed as a lever in negotiations (see paragraph 41 below for a discussion about deadlines). Of course, if earlier guidance is heeded then the scope for discussion on key commercial issues will have been limited through the scoping activity.

25. Once you have an idea of the terrain that you have to cross with your preferred bidder you can think about how you tackle those issues. It may be that there are, for example, technical, financial or commercial aspects which can be hived-out into separate work streams – for example, you may have a sub-group work on the service management regime. If you do structure the negotiation through work-streams it is imperative that those at the centre are kept up to date with issues as and when they are “resolved” and can factor

resolution on discrete areas into wider discussions which are ongoing (see paragraph 23).

26. On many projects the IPT (and the preferred bidder) have taken the view that they need to comprehensively visit all outstanding issues on the list at least once before they are in a position to have a definitive negotiation. This makes some sense since it allows each party to have its say on issues serially and then step back and look at the overall “shape” of the deal. It is also a good use of time in that the lenders’ technical advisers can make their first pass of the technical solution and requirement and begin firming up on the degree to which these documents conform with the “in principle” position adopted by lenders during the competitive stage. You may not reach resolution on all (or even most) issues during this “first pass” but – if managed properly and comprehensively – it should facilitate a better final negotiation stage and is good a platform on which to add the detailed concerns of lenders once they have had a chance to review the documentation. Clearly the view an IPT takes on an such approach will be coloured by the number and complexity of issues which it faces – it is therefore critical that a concerted effort is made as soon as possible (ideally flowing from the evaluation of the bidder during competition) to identify all outstanding issues and list them in detail.

27. Lists are also an IPT’s audit trail. There should be regular meetings convened to work through outstanding actions and push forward progress – but such meetings should clearly not be so frequent as to hamper actual negotiations of substance. The preferred bidder stage will generate its own momentum and nearing commercial close the IPT will probably find itself locked into a heavy meeting schedule. At that stage it is critical that the list of outstanding issues is updated and you must make time in the day to de-brief the team and update the list so as to inform the agenda of subsequent meetings. We have set out at Appendix 2 a pro-forma list which can be adapted and used by IPTs. The list should be viewed as a living document which is updated regularly by the IPT and its advisers (and to aid clarity each of these should use a different colour or font in so doing). **The IPT should**

clearly not share all of the content of its list as it develops with the preferred bidder. Columns 1-3 (serial, reference and title) are all that can actually be shared since the rest of the document will be a reflection of the combined thoughts of the IPT and its advisers and form the negotiation brief.

Meetings

28. If managed properly meetings can really drive forward the process. Badly managed meetings will however quickly make the entire process deteriorate into an expensive, time consuming war of attrition with a potentially fatal loss of confidence in the project. A successful meeting will have the following ingredients:

- an agreed agenda which has been circulated well in advance;
- a chairman who will drive forward the agenda and keep time, if necessary parking issues of variance to be dealt with later in the process;
- the right people from all parties in attendance;
- a “hymn sheet” of the IPT’s position on key issues on the agenda;
- access to (but not necessarily attendance from) people who can offer support at key points (for instance it may be sensible to have the IPT’s financial modeller available to test assumptions);
- the right documentation and facilities available;
- a scribe who will faithfully record action points and agreements in principle and who can read back (see paragraph 31) key points at various stages;
- a sensible end time that allows all parties to de-brief and plan for the next day/step.

29. The implication of paragraph 28 is that, initially and throughout the process, the IPT will be having a certain amount of “meetings about meetings”. This is normal. In fact, if your IPT is not having “meetings about meetings” it could be indicative that the process is not being managed either at all or (more likely) is being dictated by the preferred bidder and its lenders. In order to make best use of meetings it is therefore clear that the IPT must be absolutely crystal clear regarding all outstanding issues – this serves to re-emphasise the importance of preparation. Whilst the IPT cannot impose its will dictatorially on the other parties it should be able to set out clearly its expectations of:

- what meetings will be required;
- when they will take place;
- where they will take place;
- how long they will last;
- who it expects to attend;
- what outcomes are intended; and
- when additional meetings can be discussed.

30. For each key commercial issue on the master outstanding issues list the IPT should prepare a “hymn sheet” which sets out:

- the most acceptable outcome of the negotiation to the Authority;
- the least acceptable outcome of the negotiation to the Authority;

- the preferred bidder's position;
- possible common ground; and
- other issues that need to be considered in the same negotiation.

It is common for lenders' and consortium members' boards to require (from their advisers) a detailed breakdown on the Authority's position on key commercial issues as negotiations develop and for this to be regularly updated. The IPT needs to cover similar ground and the "hymn sheet" approach is a sensible way of so doing. It becomes *absolutely essential* to have a formal negotiation strategy on these lines after the "first pass" has occurred and the final phase of negotiations begins in earnest. At that point linkages between issues come very sharply into focus – for instance, limitations on liability cannot be discussed in isolation from insurance, indemnities, termination, compensation and sole remedy. *The IPT must have a "hymn sheet" that covers all such linked issues and be prepared to analyse how movement on one issue might impact on another.*

31. The ability to break-out of a meeting should be valued and used appropriately. In situations where positions are becoming polarised it is often crucial to step back and take stock of the key drivers on either side. The problem may well be an entrenched adviser (on either side) or that a problem is being inadequately articulated and therefore misunderstood by either party. If you do find yourself in such a position the best course of action is to call a temporary halt to proceedings so that you can probe where your own side is going, assess whether this accords with your "hymn sheet", attempt to "step into the shoes" of the other side to better understand their stance, regroup and continue. Another aid to overcoming obstacles in meetings is to have one person on either side taking a detailed note (on the Authority side this can often be done by a junior or trainee solicitor from the legal adviser team). If a key point or action is agreed it is often sensible to ask the scribe to read out

there and then what they have recorded to ensure that as much certainty is achieved as possible.

32. Drafting however must not be done in meetings. Invariably, drafting undertaken during a meeting needs to be revisited and further amplified as the implications of what has been agreed on one point become understood in the context of the rest of the deal. That said, it is possible for drafting to be turned around relatively quickly if the lawyers concerned have access to the right support. It can be extremely helpful (both in keeping momentum and maintaining confidence) if following a meeting which has been closed at a sensible hour the Authority's lawyers can spend some time in the evening producing further wording and, crucially, a mark-up of the previous draft showing changes. This is more difficult to do if the meetings are being held at an Authority venue that is not sufficiently equipped to accommodate such work and which does not, for example, have software that can generate accurate mark-ups.

Venues

33. Meetings (and especially negotiation meetings which take place after any "first pass" through the issues) should be held at the offices of the Authority's legal advisers which should (by this stage of the process) be a comfortable "home ground" for the IPT's negotiators. This should be the rule of thumb. In general the Authority is not equipped to host a complex series of meetings – it has neither the document support, the catering or the facility for breakout rooms that are required. Shifting meetings to the offices of another parties' advisers is not generally sensible – it deprives your own team of their immediate support network and (arguably) can put you on the back foot. Psychologically, it is useful to effectively announce that the project is entering its endgame by moving to a fresh venue – the fact that you are holding meetings in the legal adviser's offices heralds that there is some light at the end of the tunnel (even if it may not feel like that at all times) and – crucially - that it is *your* tunnel. The Authority needs to control meetings as far as

possible and a key part of this control is choice of venue wherever you ultimately decide to host the meetings.

34. By having meetings in its legal advisers offices the Authority is also providing itself with the maximum possible access to the strength in depth of the company concerned – so that, for example, if a point arises on an environmental indemnity (or whatever) the relevant specialist advice is more likely to be readily at hand allowing momentum and confidence to be maintained.

Document Management

35. Another rule of thumb is that any agreement (including schedules) to which the Authority will be a party or under which it may pick up a liability in consequence of its obligations under another agreement should be under its control (or the control of its legal adviser). It is crucial that the Authority (or its advisers) retains configuration control over these documents. There are possibly some exceptions to this rule but they are limited in scope and without exception the Authority and its legal advisers will require approval of their final form having been kept in the loop on their development and allowed input during the process. The exceptions are:

- The Contractor's Technical Solution (Schedule B);
- The Loan Agreement;
- Hedging Agreements;
- Sub-contracts;

Other exceptions must be looked at on a case by case basis.

36. The key concern which the IPT has in these documents is one of risk transfer and liability on termination. It must be allowed access to drafts at relevant points in the negotiations (subject to the ability of the other parties not to disclose commercially sensitive data) to determine how risks are being managed by the preferred bidder and what (if any) its liability may be on termination.

Risk Matrix

37. By the time an IPT enters negotiations with a preferred bidder it should have a comprehensive risk matrix which is cross referenced to the project documents (see DPA PFI Guidance Note: Drafting PFI Contracts) . The risk matrix is a useful précis of the position that has been reached on key risks and although it should never form part of the agreement it can form a useful audit trail of where positions have changed and in what context. It should continue to be updated throughout the process.

Personalities

38. Do not underestimate the importance of managing your team (including advisers) at a personal level. Aside from the usual problems associated with leading complex negotiations, with multiple parties, to a demanding timetable, with massive amounts of public money at issue, there are issues on PPP/PFI projects which are notoriously difficult to negotiate. In particular the payment and performance mechanism can (following many months of development in a “silo”) become a real sticking point for those involved in its creation (especially on projects which are innovative and where the concepts have been developed in a bespoke fashion). It is often a reflection of team members’ (on both sides) absolute commitment to the project that they become entrenched on certain issues and need someone in the team to *sensitively* inject some perspective into their thinking. It is therefore important that an IPT Leader (in particular) can recognise where a loss of perspective has occurred and step in to address the issue in a sensitive and timely

fashion. A pragmatic approach that doesn't let perfect get in the way of good but also doesn't alienate or de-motivate key personnel is required. The IPT Leader also needs to recognise that a different skill-set is required during the final complex stage of the negotiation – team members who have been powerhouses of innovation and creativity during the inception of the project may lack the “completer/finisher” skills necessary for closure. Recognising this and playing to the team's strengths can alleviate a further source of stress in the process.

39. The “personality” of the preferred bidder can also change. Personnel on the bidder's side with whom the IPT has built a relationship over the preceding months and years sometimes disappear to their next sales assignment with a completion team of battle-hardened “closers” moving into their place. There is very little that an IPT can do about this once it has happened, but questions should be asked during the evaluation stage about the stability of the bidder's team and who will be conducting negotiations post preferred bidder status being conferred. If it does happen, the only real safeguards which an IPT has are the robustness and clarity of negotiations achieved on key issues to date – again this serves to emphasise the importance of preparation and the explicit link between the evaluated position and the position taken during the uncompetitive phase. If a change in personnel does materially alter the character of negotiations to such an extent that a re-negotiation of previously closed positions is actually afoot, then the IPT must act swiftly and decisively to assert control and, ultimately, may need to cease negotiations and look to any reserve bidder it may have (this has only happened once in the PFI market to date but if there is a reserve bidder then it could be a credible threat) or even look to re-visit its shortlist (although query how real an option this is in practice – especially if there is some distance in time between the appointment of preferred bidder and the breakdown in relationship).

Lenders

40. Lenders want to invest in your project but can only do so if they satisfy their credit committees on the risks. Often their advisers are blamed for being overly cautious and pedantic. This is not (entirely) fair. There is no mileage in becoming frustrated by the speed at which lenders (or their advisers) are prepared to move since this is dictated in large measure by the way in which the IPT (in particular) and the preferred bidder have presented the project to them. A coherent set of documents which read together, a robust and well argued audit trail on risk and a sensible framework for and timetable to commercial and financial close will create confidence in the lenders that the IPT and the preferred bidder have a cogent “story to tell” and that – subject to due diligence – the project is bankable. Lenders should have been required to agree in principle the key legal terms and if possible the draft agreement during the evaluation process but if the process has been badly managed then their sign-off will have been more than usually caveated. Disarray and confusion will cause the lenders to be suspect of everything – compounding their already significant technical due diligence requirements with an added layer of scepticism. Manage the process well with your preferred bidder, take advice from your advisers on the bankability (or not) of key risks *prior to down-selection* and the lenders’ requirements will be easier to accommodate.

Timetables

41. All of the above should have instilled an appreciation of the importance of planning and time-tabling. IPTs should not underestimate the time taken to plan for this stage and should be mapping out progress to financial close with the preferred bidder, its lenders and all other interested parties within days of appointment of preferred bidder. Simple things like asking key players (including advisers) when they are on holiday during the next six months/year and enquiring what other major deals advisers are acting on (which may conflict with your project) will assist in building up a realistic timetable to completion. IPTs should not be optimistic about timing - however pressing the demands of the customer may be - and must manage the customer’s expectations in this regard. The preferred bidder process can be long and

arduous – especially where guidance such as that contained in this note is not followed. It is far better to build more time into the process than you believe is necessary than to find your negotiation position prejudiced by an overly ambitious deadline which has been set without any regard to the maturity of the project or external influences such as the availability of advisers. An IPT should never find itself conceding points because it has imposed an artificial and overly ambitious deadline on itself – a wily preferred bidder will spot such “drop dead dates” and may actively manipulate the process to its advantage.

Flexibility

42. Having planned the process, worked up its lists and adhered to the advice above (and that from its advisers) the IPT can approach the preferred bidder stage with confidence. That confidence will allow the IPT some flexibility in its approach and this is also a key attribute of a successfully managed endgame. Having a timetable and lists of issues to work through is not an end in itself – *there will be occasions where more time is required for a better informed and higher quality debate on issues and the IPT should have enough slack in the process to accommodate this.* New issues will arise and must be addressed and again they will have an impact on timing and will require flexibility.

Completion

43. Never underestimate the length of time or preparation required for completion. As can be seen from Appendix 1 the process to financial close is complex. Once you have settled all of the issues on your documentation there will be rafts of ancillary board minutes, powers of attorney, security documents etc. which require further work and development. The issue of when to enter the interest rate swap will also require careful planning and consideration (clearly in conjunction with advisers). Do not place IPT members or advisers under undue pressure in the later stages – especially if there are still live issues to be negotiated. The deal cannot be signed until all

of the documentation is ready. All of which said, the IPT should be looking to its advisers to provide as early in the process as possible a completion agenda and list of completion documents and should – periodically – require all parties to report on progress in developing the various documents. Again, all of the above will be further complicated and the timetable extended by the addition of a funding competition.

Loss of Competitive Tension and Uncompetitive Re-pricing

44. The biggest and most challenging aspect of preferred negotiations is the sea-change in relative bargaining position that down-selection to a single bidder heralds. Where once the IPT had two or three bidders against whom competitive tension could be leveraged it now has to face up to the fact that the preferred bidder is the “only show in town”. Loss of competitive tension is not a risk that can be avoided – it will *always* be present in a situation where there is a sole bidder (hence the emphasis in the earlier guidance on the eight pre-requisites for selection of a preferred bidder). IPTs must focus on how they and their advisers will manage that risk and successfully conclude their projects. Projects which have not:

- comprehensively identified and negotiated key issues prior to down-selection; and/or
- optimised the Authority’s position by using competitive tension;

are likely to have either:

- an extended period of preferred bidder negotiations; and/ or
- risk signing a deal on sub-optimal terms; or
- both;

and may moreover open themselves to challenge from disgruntled bidders who were not taken forward on the basis that the deal struck with the preferred bidder is materially different from that evaluated.

45. So what *should* have happened prior to appointment of the preferred bidder to manage the risk of losing competitive tension? Ideally, the “core of the deal” should have been settled in detail with the preferred bidder and approved as “bankable” by its lenders prior to down-selection and the Authority should have confidence that the price which it has been quoted for the services is stable and will not be subject to further material change. The preferred bidder and the IPT should be presenting a united front to the lenders in terms of what *their* project is about and, critically, the risk allocation that has been achieved. Ideally, the preferred bidder should be acting as a true “sponsor” of the project with regard to lenders - building on the commonality of interests and understanding of the IPT’s position which it has developed over the preceding months. This is not to say that the IPT can, in effect, delegate the protection of the Authority’s interests to the preferred bidder – that would be inadvisable. Rather, the ideal proposition should be that through the course of negotiations (while there is still competitive tension) the IPT and its preferred bidder should be able to develop a common front on all critical risk issues that they are comfortable in “selling” to the lenders. In effect, the Authority and its preferred bidder should have reached “commercial close” or be very near to so doing and have obtained agreement in principle from lenders to this position. For a more detailed explanation of what the key considerations are IPTs should read the DPA PPF’s Guidance on Selection of a Preferred bidder and in particular the eight prerequisites for selection of a preferred bidder set out below:

- proposals that meet the output specification;
- value for money;

- acceptance of key commercial provisions;
- acceptance of risk transfer;
- no scope to seek price revisions;
- confirmed access to finance;
- affordability;
- cohesive team.

46. In reality, what often happens is that a preferred bidder (having successfully caveated its position on key issues without an appropriate level of challenge from the Authority during its evaluation of bids) uses the hurdle of lender due diligence to further erode and undermine the risk transfer that has been “agreed in principle” on the basis that it is “unbankable” once the “devil in the detail” becomes apparent. In circumstances where the Authority’s requirements have not been adequately expressed in its output specification (and are either ambivalent and/or subject to change) the preferred bidder will often seek to add to its price – and of course without the discipline of competitive tension the IPT cannot be certain whether a given price adjustment represents value for money. In such circumstances there is little or no prospect of the IPT and its preferred bidder presenting a united front (either before or after down selection) to the lenders and the process will become protracted and complex as each party struggles to assert its view on risk transfer and its impact on price. The opportunity to engage in uncompetitive re-pricing is something which many bidders are keen to exploit at this stage of the process. Equally, where the Authority’s requirement is unclear or changes the preferred bidder is often forced to revisit its pricing as the intended risk allocation becomes clearer.

47. Uncompetitive pricing generally arises due to two main reasons:

- price validity lapses; and
- requirement change.

Strategies to deal with the former are basically centred on the Authority showing foresight in terms of the proposed preferred bidder’s bid validity and planning in advance how any change (to take account of inflation or interest rates) will be factored into the revised price. The latter is really a question of ensuring that as far as possible the Authority has settled its requirement during the competitive stage and that, in consequence, there will be no material changes involving re-pricing during the preferred bidder period. Unfortunately it is not always possible to close down the requirement and IPTs are often confronted by requests from their customers for late additions to the specification.

48. So how can an IPT manage uncompetitive re-pricing during the preferred bidder stage? We have listed below a number of techniques that should be used:

Understand the Preferred bidder’s Pricing Structure

49. In order to police any shifts in price by the preferred bidder the IPT must understand how that price was built up initially and what the effect of the proposed change will be. All bidders should have been required to break down their headline NPV figure for the project into its constituent elements. The level of granularity that is required should be sufficient to enable the impact of any re-pricing to be understood on a “before” and “after” basis and equip the IPT to ask sensible questions about any other additional costs which may have crept in. At the very least, the following components should be isolated:

Item	Amount before	Amount after
------	---------------	--------------

	change	change
Operating Expenditure		
Subcontracts		
Debt: Interest		
Debt: Principal		
Subordinated Debt: Interest		
Subordinated Debt: Principal		
Equity: Dividends and Repayment		
Capital Expenditure		

50. It is not uncommon (however hard an IPT tries to police the Authority's output specification) for changes to be made to it during the uncompetitive stage. It is equally common for preferred bidders to attempt to fix faults in their pricing strategy at the same time – using the re-opening of the output specification as a pretext for fixing (or even adding to) costs which they had originally got wrong. If the IPT understands the basis on which the bidders' bids have been put together then there is much less scope for "re-pricing creep" to occur.

51. If a bidder has made a mistake in its pricing strategy it is far better for this to be raised transparently with the IPT. A sensible discussion can be then be had on whether the fault is so great that it would have materially altered the decision to down-select, what (if anything) can be done to address the bidder's concerns and whether this should include some element of re-pricing. The Authority does not want to be locked into a long-term deal with a bidder who (having made an honest mistake) is driven to look for cost savings which may prejudice service levels but, equally, does want to be exposed to massive uncompetitive re-pricing. A balance needs to be achieved between understanding and accommodating errors and ensuring value for money. This balance can only be achieved if the bidder is open and frank regarding its pricing and the IPT is clearly best positioned to require this behaviour through

its dealings with all bidders prior to selection of the preferred bidder. Any re-pricing also needs to be assessed in the context of the overall deal and the ebb and flow of concessions that occurs during negotiations. Each issue needs to be assessed on its merits but it would be naïve of an IPT to think that a “score card” was not being kept of concessions and the IPT should certainly have one eye on the ground that it might be prepared to give in principle (once satisfactory agreement has been reached on all other outstanding issues).

Understand the Financial Model and Assumptions

52. The financial model and the key assumptions upon which it rests should be capable of being read and understood by the IPT. The financial model is often be a document produced in isolation with very few people involved with its production and iteration and, in consequence, very people aware of its role in capturing key pricing assumptions.

53. IPTs should periodically instruct their financial advisers to report to both the commercial and technical elements of the team on the progress of the financial model. During negotiations it is very important that the financial modeller is kept up-to-date with developments and (crucially) is able to react from a financial model perspective on any revised positions which impact on price (see paragraph 23). The key message is that the modeller (if not in the actual negotiations) should keep pace with the negotiations so that the model is as up-to-date as possible. IPTs need to develop a strategy for ensuring that this is achieved whilst still maintaining the required degree of momentum in negotiations.

54. If a methodology can be established whereby at key points (and say at least once a week) the modeller is brought up to speed then all parties should benefit from much better informed negotiations with less scope for surprises nearer the completion date. On an uncompetitive re-pricing as well as understanding how the revised price impacts on the component parts of the

NPV calculation it is important that IPTs understand how any underlying assumptions in the financial model have been developed or changed – this cannot be achieved unless the model is readily understandable by and transparent to the IPT.

Key Messages

Be clear on the basis of appointment of the preferred bidder and the degree to which lenders support its position

List all outstanding points and prepare “Hymn Sheets” on key commercial issues

Work with the preferred bidder to present a common position on risk to lenders

Plan everything in detail but build in flexibility to your timetable

Assess the risk of uncompetitive pricing and manage it appropriately

Have a clear output specification

Be clear on the basis of any re-pricing

Understand the preferred bidder’s price

Monitor affordability throughout using the financial model

APPENDIX 1

INDICATIVE TIME LINE

IPTs should be developing their own time-line in conjunction with advisors using the appropriate project planning software.

Month or so pre-appointment of preferred bidder

Final review of evaluation of bids and level of lender support

Approvals process completed

Revision of documentation to capture all agreed points

Draft list of outstanding issues and “Hymn Sheets”

Re-visit bid validity and consider risk of re-pricing

Establish basis of appointment of preferred bidder and draft appointment letter

[If funding is to be competed establish detail of process to be followed]

Consider reserve bidder and de-brief strategy for other bidders

Brainstorm approach with advisers, key stakeholders and PPF1

Produce gantt chart of proposed timetable

Issue of Preferred bidder Letter

Provide preferred bidder letter outlining basis of appointment

Provide list of outstanding issues

Provide revised documentation

Involvement of lenders' advisers and commencement of due diligence (especially technical due diligence)

Draft Completion Agenda and Completion Documents List

Issue of Preferred bidder Letter plus 2 weeks

First meeting to agree list of outstanding issues between IPT, preferred bidder and lenders

Subsequent meetings to agree list of outstanding issues

Confirmation of appointment of preferred bidder and basis of appointment

Lender due diligence ongoing with lenders' advisers formally tasked

Issue of Preferred bidder Letter plus 3-4 weeks (assuming that list of outstanding issues can be agreed and appointment as preferred bidder can be confirmed)

First “meeting about meetings” to plan negotiations

Lender due diligence ongoing

Issue of Preferred bidder Letter plus 4-5 weeks

Meeting with lenders to present agreed IPT/preferred bidder plan for negotiations and obtain lender comment and commitment to timetable.

Lender due diligence ongoing

Issue of Preferred bidder Letter plus 2-3 months

“First Pass” through outstanding issues (including lender issues)

Lender due diligence ongoing

Issue of Preferred bidder Letter plus 3-5 months

Production of Information Memorandum by preferred bidder

Lender due diligence ongoing

Formal review of current issues list and comparison to deal evaluated at BAFO

First report from lender's advisers

Lender's involvement in commercial negotiations to extent due diligence has altered its "in principle" agreement

Final Report from lender's advisers

Agree Completion Agenda and Completion Documents List
Sensitivity testing on Financial Model

Issue of Preferred bidder Letter plus 5-7 months

Sub-contracts settled

Financial Model settled and audited

Final negotiations leading to commercial close

IPT Review Note

Finalisation of all subsidiary and financing documents, sub-contracts, board minutes etc.

Financial close and completion

APPENDIX 2

PRO FORMA ISSUES LIST

Key to Comments (in colour)

Authority IPT Leader	<i>Financial Modeller</i>
Authority “Right Hand”	Technical Adviser
Legal Adviser	PPFI
Financial Adviser	

Serial	Ref	Title	Issue	Comment	Risk Allocation

All issues should be accorded a unique serial number.

All issues should be cross referenced to the relevant section(s) of the documentation

All issues should be given a title

Each issue should be described

As issues are resolved or discussions develop the commentary column should be populated by those involved and each entry should be dated

The risk allocation should also be recorded

Issues which are subject of an additional “hymn sheet” should be identified along with the “owner” of any such document