



**MOD Private Finance Unit
Guidance Note
Preparing the Invitation to Negotiate
for PFI Projects**

Version 2

August 2008

© Crown copyright 2008

The text in this document (excluding the departmental logo) may be reproduced free of charge in any format or medium providing that it is reproduced accurately and not used in a misleading context. The material must be acknowledged as Crown copyright and the title of the document specified.

MOD PFU Contacts

This document can be found on the MOD PFU website at :

<http://www.mod.uk/DefenceInternet/AboutDefence/WhatWeDo/FinanceandProcurement/PFU/PrivateFinanceUnit.htm>

For general enquiries about MOD PFU and its work, contact:

MOD Private Finance Unit Front Desk
Spruce 1, #1103,
MOD Abbey Wood,
Bristol BS34 8JH

Tel: 0117 9132639 (9352 32639)
Email: MODPFU-Front Desk@mod.uk



DOCUMENT CHANGE RECORD

This is a controlled document. Additional copies can be obtained through the issuing authority. Amendment shall be by whole document replacement. Proposals for change are to be forwarded to the issuing authority.

Issue No	Details Of Amendments Made	Amended By	Date
1	First Issue	O Ellis	December 1998
2	Minor update	R Haria	August 2008

CONTENTS LIST

Document Change Record.....	3
Contents List.....	4
Constraints	5
Authoritative Guidance Summary.....	5
Authoritative Guidance	5

Preparing the Invitation to Negotiate for PFI Projects

Constraints

1. The EC Public Procurement Regulations apply to MOD contracts unless the nature of the work qualifies for an exemption. Reference must be made to the detailed guidance on the mandatory procedures to be followed.

Authoritative Guidance Summary

2. This document provides guidance on the preparation required for a successful launch of the Invitation to Negotiate (ITN). The ITN is the foundation for Private Finance Initiative (PFI) procurement and is issued to short-listed suppliers.
3. The paper identifies the work required in the preparation of the ITN that is necessary to ensure a successful subsequent procurement. It achieves this by focusing on:
 - The contents of the ITN;
 - The preliminary work to be undertaken prior to, or soon after, ITN issue that will ensure MOD is in the best position to respond accurately, effectively and in a timely fashion to negotiations in such a way that leads to a successful closure as quickly as possible.
4. The ITN in a PFI procurement differs from a conventional procurement's Invitation to Tender (ITT) or Request for Proposals (RFP) in both content and objective. Consequently it requires a substantially different programme of preliminary work to be completed at the equivalent stage of the procurement.
5. It is not intended that this guidance should be overly prescriptive; different projects will have different requirements. However the paper does provide a valid model for the consideration of any PFI application. Hence, the project team should be able to explain and justify the rationale for any variance from planning for, and undertaking, the tasks listed in this note.

Authoritative Guidance

IMPORTANCE OF THE ITN

6. The ITN represents the foundation for the PFI procurement process and should set out the MOD's initial negotiating position such that:
 - the non-negotiable elements of service requirements, contracting terms, and risk allocation are clearly stated;
 - there is a mandatory framework (governing, for example, MOD's proposals for risk allocation, the payment/performance mechanism and contract management structures) upon which bidders can build compliant bids whilst encouraging alternative solutions that may offer advantages in terms of improved efficiency, effectiveness and/or overall value for money;
 - there is sufficient flexibility in the requirement (expressed in output terms) to encourage innovation in the proposals.
7. Authors of the ITN - especially those responsible for the Statement of Service Requirement - should seek explicitly to identify areas where innovation or suggestions are sought from the private sector. Such areas may be where the nature or scope of the Requirement is legitimately uncertain or where there are known - or suspected to be - alternative approaches to those traditionally taken by MOD.

CONTENTS OF THE ITN

8. The contents of the ITN must reflect the above issues and specifically recognise that the document:
 - provides the *commercial framework for a contract* that is significantly different to the scope and mechanisms of traditional MOD Prime Contractorship.
 - is *a basis for negotiation* and is therefore not nearly so definitive a statement as a conventional ITT.
9. Nevertheless, the ITN contents, reflecting PFI's more flexible approach based on stakeholder dialogue, is wholly consistent with MOD's wider adoption of SMART procurement principles.
10. A "model" contents list is outlined in Table 1. The actual format (whether certain sections should be combined or divided or presented as separate volumes or as Annexes) needs to be agreed on a case-by-case basis.

QUALITY OF THE ITN

11. Given the importance of the ITN and the fact that it is the first formal document of a long and potentially expensive bidding process, the quality of the document - in terms of content and presentation - can be

crucial. It demonstrates MOD's professionalism and their commitment to PFI and this in turn will have a direct impact on the commitment of the bidders.

Table 1: CONTENTS OF THE ITN

<i>Section</i>	<i>Title</i>	<i>Outline Contents</i>
1	Overview	An executive summary of the key points from each of the ITN sections which sells the project and the vision. A “health warning” should be included recognising the provisional nature of the information provided.
2	Proposed Commercial Relationship	The suggested nature of the relationship between the successful service provider and MOD, outlining the principles of the PFI arrangement and the proposed supporting mechanisms. Principles of risk allocation.
3	Scope	A high level description of the services being sought under the procurement and specifically the technical/functional/operational boundaries, including areas <u>definitely</u> excluded from the project scope.
4	Service Requirement	The detailed output-based specification of the service requirements.
5	Performance Measurement and Payment Models	The proposed structure and nature of the performance measurement and payment mechanisms to be employed in setting the PFI unitary service charge.
6	Transition Management (if appropriate)	The plans for implementing the new service, whilst minimising the effect on existing operations, leading to the successful service provider taking full responsibility for the service delivery
7	Response required from bidders	The nature, scope and format of the responses to the ITN required from the bidders and other appropriate instructions to bidders. Outline bid evaluation methodology (including criteria listed in order of priority)
8	Draft contract	Heads of terms. Draft model contract should be attached.
9	Supporting information	As appropriate for amplification/clarification of key issues. The Public Sector Comparator.

WORK TO BE UNDERTAKEN PRIOR TO ITN ISSUE

12. This section summarises the work that needs to have been undertaken prior to or shortly after the issue of the ITN. The work described does not necessarily contribute directly to the ITN document itself.

Preliminary Work

13. If procurement activity subsequent to the issue of the ITN is to proceed with maximum effectiveness and speed, it must be underpinned by the completion of a number of items of “preliminary” work.
14. It is assumed that the following preliminary tasks have already been undertaken prior to the drafting of the ITN:
- Production and approval of the Procurement Strategy
 - Initial gate approval (as appropriate to project scale and type), including the Staff Requirement and COEIA
 - Production and approval of Approvals Strategy for entire procurement
 - Issue of OJEC notice/Contracts Bulletin notification (as appropriate)
 - Issue of prospectus/Memorandum of Information (with PQQ) to organisations expressing interest to OJEC/advert
 - Production and approval of evaluation strategy for entire procurement
 - Production and approval of evaluation model for initial expressions of interest.
15. The remainder of this Section discusses the various pre-ITN tasks supporting each of the sections of the ITN plus a number of general tasks.

General Tasks

16. Procurement Planning. A Gantt chart should have been constructed that includes all key PFI stages and activities. A model of such a Gantt is at Annex A.

17. Public Sector Comparator. An agreed Public Sector Comparator should be defined and costed representing what MOD would do if it was not to proceed under PFI.
18. Commercial Feasibility. If there was any doubt regarding the likely interest of the market in a PFI opportunity of the type being proposed (and note that the PFI market is neither especially predictable nor consistent) a commercial feasibility study should have been undertaken. This should have sought the views of a selected sample of the market on their interest in the provision of the services required and any complications they foresee to the delivery of a cost-effective service under PFI (risk transfer, interfaces and other dependencies, third party revenue etc.).
19. *It should be recognised that the uncertainties inherent in the scope, solution and costs of a PFI service at this stage will rarely provide a clear demonstration of the vfm advantage of PFI. The best that is normally achievable is a clear rationale for why PFI could deliver improved vfm supported by an investigation of other feasibility drivers and any potential showstoppers.*
20. Communication and negotiation. A process for managing, recording and co-ordinating communication between the project team and the suppliers throughout the procurement needs to be outlined and internal resources identified and assigned. This should take account of the fact that the suppliers could require discussions with a large number of stakeholders. Projects of a significant size will probably require dedicated liaison staff to control the flow of information to and from each of the bidders.
21. Scaling and baselining. Depending on the nature of the service being provided, it may be necessary to provide - or be in a position to provide - the bidders with volumetric data defining the size of the operation and the number of times certain processes are carried out over a given period of time. This not only provides the bidder with a basis for costing the service provision - minimising the scope for including contingencies - but can also provide a baseline of the current operation against which service performance and improvements can be measured.
22. Data Room. A mechanism should be set up to provide bidders with access to any document referred to in the ITN or any

other information that is considered to be of potential value. This is often best achieved by organising a data room which individual bidders can book time in. All documents provided in the data room should be made available with the understanding that MOD is not warranting the information in any way.

Commercial Relationship

23. Commercial structures. An outline of how MOD expects to see the contracting process being monitored and managed should be included in the ITN. This structure should not be mandatory but offered as a benchmark, against which alternative proposals can be considered.
24. Commercial processes. The key mechanisms by which the commercial arrangement will be developed and managed should be drafted. High level descriptions should be provided for the key mechanisms such as: payment, performance monitoring, change control, benefit sharing etc.
25. Risk. An initial risk matrix should be drafted and agreed that sets out MOD's initial position with respect to the allocation of risk between MOD and the service provider. At this stage it is usually adequate simply to list the major areas of risk (at least to the level of the HMT headings) and identify whether it is expected to be owned by MOD or the service provider. It is helpful to further define any "shared" risks to clarify where the boundary of ownership is expected to be. Again, this matrix should be presented as an initial negotiating position not a *fait accompli*. Examples of risk matrices can be provided by the PFU.

Scope

26. Core functions. It is of the utmost importance that the MOD has agreed a clear (and operationally justified) position regarding functions within, or adjoining, the nominal project boundary that cannot in any circumstance be transferred to the private sector under PFI. It is also helpful to have any "grey areas" defined where MOD's preference is for, say, Armed Services operation, but where proposals for private sector operation may be considered if there are compensating benefits that offer improved value for money and do not compromise overall operational effectiveness.

27. Service boundaries. The MOD must have given full consideration (i.e. to the appropriate level of authority) to possible extensions to the scope of the project to cover either additional functions within the same operational area or similar functions in different areas. It is in the nature of PFI that such proposals are likely to arise from industry in the weeks following ITN issue and it is important therefore that MOD can provide timely, accurate and justified responses to such questions.
28. *Major uncertainties remaining in these two areas at the ITN issue stage represent a considerable risk to the Feasibility of PFI projects. Such unresolved issues could at best result in a sub-optimal solution being delivered and at worst result in extensive delays and/or the failure of the PFI procurement.*

SERVICE REQUIREMENT

29. Output requirements. The Statement of Service Requirements (SSR) must express the desired outputs of the service being procured with the minimum of prescription of the solution required to deliver it. Unnecessary detail should be avoided. The SSR must make the clearest statement regarding the nature and scope of possible changes to the requirement - or the operational context in which the service is to be delivered - over the course of the contract. This is especially important if the intention is to allocate some or all of the risk associated with the change to the private sector (i.e. through a service requirement that incorporates flexibility).
30. Prioritisation. It is extremely helpful to the Bidder and can simplify/shorten the analysis/negotiation period to provide simple prioritisation of the individual requirements in the SSR. The conventional labels of "Essential", "Highly Desirable" and "Desirable" may suffice.
31. Performance Standards or Targets. If possible, performance indicators should be included in the SSR for each requirement. This helps drafting by demonstrating to the Users that quantifiable output requirements have been defined and shows the Bidders what the likely low level service performance measures are likely to be. They are also key to the production of an effective Acceptance plan.

Performance Measurement And Payment Models

32. Key Performance Indicators (KPIs). KPIs are the high level measures of the quality of the delivered service and provide metrics for the payment mechanism. Their early identification and inclusion in the ITN ensures that the Users and Bidders are both focused on what is operationally important (and measurable) in the final service delivery.
33. Payment Principles. MOD should have agreed the basic principles of the payment mechanism to be employed in the derivation of the unitary service charge. These principles should - as the basis for negotiation - define the degree to which performance, availability and usage measures are proposed to be used in calculating payment.

Transition Management

34. Transition issues. An early awareness of the key issues with respect to the period of transition, service continuity and associated change management will be helpful in directing proposals to address the issues adequately.

Response Required From Bidders

35. Financial Models. MOD should have defined the format in which they require Bidders to provide financial information supporting their proposals. The metrics to be used in the financial comparison of proposals should be identified and defined unambiguously. An electronic version of the financial model to be used in the comparison should be provided to the Bidders to ensure that their responses are formatted consistently.
36. Evaluation model. The evaluation model to be used in assessing Bidders' responses should be drafted and agreed prior to ITN issue.

Draft Contract

37. Contract. The ITN should contain the Heads of Agreement and as complete a contract as possible. *At a minimum* this should include full drafting of areas that are unlikely to be controversial and clear expositions of principle in areas that are likely to be the subject of negotiation (such as those relating to key areas of performance risk allocation). Further advice and examples are available from the PFU.

SUPPORTING INFORMATION

38. Public Sector Comparator. If it has been agreed to release the PSC, (and it generally should be, except in single tender situations or where it might damage the competition), it should be included in the ITN at whatever level of detail has been agreed as striking the optimum balance between private sector need and MOD's negotiating position.
39. Current assets. If the project involves the evolution from, or direct use of, existing assets, an inventory will need to be provided of the equipment, specification and location (as appropriate).
40. Other information. This should be provided as appropriate to making the ITN self-contained. Less critical - or voluminous - supporting information can best be supplied via the data room (see paragraph 22).

Annex A

Model Gantt Chart for PFI projects

[The model is provided for guidance only. If in doubt, the advice of the DPA PFG should be sought before applying this model to any given project.]

Key:

BAFO: Best and Final Offer

EoI: Expression of Interest

Mol: Memorandum of Information (also known as project brief or prospectus)

OBC: Outline Business Case

SSR: Statement of Service Requirement

[Treasury Task Force PFI process stage numbers are given as applicable]