Investigation into concerns raised by the William Pears Group about the conduct of the competition for the NHS Estates PPP

NATIONAL AUDIT OFFICE

Introduction

1. At a meeting on 5 November 2002 representatives of the William Pears Group (Pears) gave the National Audit Office a letter which raised a number of concerns about the award of preferred bidder status by NHS Estates during the competition process for a Public Private Partnership (PPP) involving the sale of NHS Estates' surplus property portfolio and a consultancy firm, Inventures. Pears told the National Audit Office that WS Atkins (Atkins), its partner in its bidding consortium (Health Estates), had decided not to take an active role in pursuing these concerns. The concerns related to Pears' belief that there was not a level playing field. It considered that there were conflicts of interest on the part of two of NHS Estates' advisers. It was also concerned in case the top management of Inventures may have preferred another bid and influenced the decision on this basis. At a later stage, Pears raised some other concerns about the conduct of the disposal. These issues are discussed below.

Background

2. In 2000 the NHS review "Sold on Health" recommended that the option of a one off sale of the surplus health estate, managed by NHS Estates be explored. A quinquennial review also in 2000 recommended that NHS Estates should no longer provide basic property consultancy services to the National Health Service and should focus instead on policy and strategic advice. After an evaluation of the options NHS Estates announced in 2001 their intention to offer to the market, as a PPP deal, both the surplus estate and Inventures (which is primarily a property services consultancy, comprising some 250 staff). As at end-December 2003 the PPP deal had not been concluded. The expected proceeds, which come almost entirely from the property portfolio, are some £400 million.

3. NHS Estates obtained advisory input to the design of the sale process during early 2001. Following expressions of interest they shortlisted four bidders in August 2001. Initial bids were received on 8 May 2002. In July 2002 the Miller Group consortium (Miller and HBOS) and the Health Estates consortium were asked for best and final offers (BAFOs), which were received on 8 August. On 28 August following discussions with bidders and evaluation, NHS Estates selected the Miller Group consortium as their preferred partner, subject to agreeing Heads of Terms. The final deal involved up-front payments for the leasehold properties in the Estate followed by further payments payable on key events such as the grant of planning consent. As part of the final deal the same consortium also agreed to buy Inventures.

4. Pears expressed disappointment at not being selected as preferred bidder to NHS Estates on 29 August 2002. On 5 September 2002 Pears' legal representative wrote to NHS Estates raising specific concerns about the manner in which the final decision was reached. Pears was not satisfied with NHS Estates' response. Legal advisers to both parties corresponded for some time to try to resolve the issues. On 24 October 2002 Pears informed NHS Estates that it reserved the right to seek a judicial review of the decision although it has not sought one. NHS Estates took advice from Queen's Counsel, who concluded that NHS Estates' had acted lawfully.

5. It is unusual for the National Audit Office to become involved prior to completion of a deal. The Department of Health agreed, however, that the National Audit Office should carry out a review of Pears' concerns at this stage. Both parties agreed that it was important for the decision-making process to be fair and be seen to be fair as well as for there to have been a clear and unambiguous process to strengthen public confidence in the legitimacy of the decision. A lack of transparency can give the impression, even when a decision is fair, that other interests may have prevailed. The National Audit Office intends to examine the PPP when it is concluded with a view to reporting to Parliament.

Work undertaken by the National Audit Office

6. In investigating Pears' complaints, the National Audit Office took account of work already undertaken by the Department of Health and NHS Estates on the bid process and the decision to appoint the preferred bidder.

7. The National Audit Office undertook a review of documentation produced as a result of this work, and, in addition, key supporting documentation from the bid process itself.

8. The National Audit Office conducted interviews with key parties:

- Pears;
- NHS Estates;
- the Chief Internal Auditor to the Department of Health, a member of the PPP Steering Group which took the decision to appoint the preferred partner;
- the top management of Inventures;
- KPMG, who gave financial advice to NHS Estates on this particular transaction;
- IRE, property advisers to NHS Estates;
- the Miller Group; and

- Atkins.

9. The National Audit Office appointed property consultants, King Sturge, to advise them on:

   - the sharing of information on an alternative bid by Health Estates;
   - the relative experience of the Miller and Health Estates consortia and the scoring produced by NHS Estates property consultants, IRE;
   - the property scores for a series of properties identified by the National Audit Office and King Sturge; and
   - the extent to which the scoring system and evaluation methodology met the objectives set out in the Invitation To Negotiate (dated 1 February 2002) (ITN) and produced a fair result.

Conflicts of Interest

10. Pears questioned whether potential conflicts of interest in two of NHS Estates' advisers had an adverse impact on the evaluation process.

Ex Chairman of IRE

11. Pears were concerned at the acceptance by the ex-Chairman of IRE, property consultants to NHS Estates, of a position as a non-executive director of the Miller Group at the end of the bidding process. IRE provided important advice on the methodology for the evaluation process, particularly on how the property details of the bids should be scored, which they designed, and the evaluation of the experience of the two shortlisted bidders. IRE were involved throughout the process. The methodology for bid evaluation was outlined in the ITN and, to an extent therefore, the process was transparent to all bidders. The marking in detail of bids is, however, inevitably a somewhat subjective process.

12. The hypothetical risk involved in a senior person becoming a Board member of one of the bidders is that (i) their judgement could be affected by the knowledge of their future employment; and/or (ii) that they would be in a position to carry with them or obtain important knowledge of the process allowing them to influence the evaluation. IRE confirmed in writing to the National Audit Office that the individual concerned left the firm on 31 December 2001 and joined the Miller Group on 2 September 2002. NHS Estates did not request bids for the PPP until early in 2002, and at that time had not completed details of its proposed evaluation methodology. BAFO bids were not required until July 2002 and the decision to appoint the preferred bidder was made on 28 August 2002. The opportunity for influencing the bids would encompass trying to influence the evaluation team or passing information to the Miller Group.

This would have necessitated the individual having sufficient knowledge of the detail of the methodology used to evaluate the bids, and passing this information to the Miller Group, so that they could tailor their bid to maximise their chances of being selected as preferred bidder.

13. It is difficult to be clear as to the level of detail such an individual would actually have had about one of the (many) projects that IRE was undertaking. In their letter IRE informed the National Audit Office that, as far as they were aware, the individual in question had had no contact with any members of the team at IRE in relation to the NHS project during the period of instruction. At the time he left IRE, the evaluation methodology had not been finalised. The remaining question then would be whether he contacted members of the IRE team advising NHS Estates on this project after he had left the organisation, and obtained information on the details of the methodology. The three senior members of the evaluation team that we spoke to said they had not had any contact with the individual.

Finding: IRE confirmed in writing to the National Audit Office that the ex-Chairman left the firm on 31 December 2001 and joined the Miller Group on 2 September 2002. We have found no evidence that the acceptance by the ex-Chairman of IRE of a position as a non-executive director of the Miller Group had any influence on the process.

Evaluation of experience by IRE

14. Part of the property evaluation conducted by IRE was an evaluation of the experience of the bidders and the quality of their bid. Pears suggested that Health Estates were marked lower than the Miller Group, when they should have been marked higher. This exercise took place after the ex Chairman had left IRE.

15. The NAO commissioned King Sturge to review the evaluation of the experience of the bidders. King Sturge concluded that, in their professional but inevitably subjective opinion, they would have scored the two bidders differently, shifting Health Estates to a two point advantage on the basis of the original weightings. Their professional judgement was also used to adjust the weighting of the questions to what they considered to be more appropriate. On this basis the gap narrowed to one point in favour of Health Estates.

16. NHS Estates told us that they believed that King Sturge did not have all the available information needed to evaluate the bidders on health, safety and environmental issues and this would have affected the evaluation which they made. Documentation subsequently produced by NHS Estates support King Sturge's findings as it showed that the health and safety evaluation of the Miller Group bid took into account information relating to a party which had withdrawn from the consortium by the BAFO stage. Adjusting for this supports King Sturge's

assessment which gave the Miller Group consortium a lower health and safety evaluation than Health Estates.

17. Paragraph 51 below, however, sets out the results of sensitivity testing by the National Audit Office of the overall evaluation of bidders. This shows that King Sturge's changes to the scoring are not sufficient to alter the outcome of the overall evaluation in favour of Health Estates.

Figure 1 King Sturge Technical Assessment

King Sturge conducted a review of the bidders' submissions and, using the IRE criteria, scored Health Estates higher in respect of the quality of bid and experience of the bidders.

Technical Assessment	Maximum	Health Estates	Miller Group consortium
Does the bidder's overall submission demonstrate a thorough understanding of the PPP Estate properties and the issues and innovation which will produce HBUV, and are the proposals realistic overall?	8	6	6
Has the Bidder demonstrated a track record of achievement in financing and developing similar properties and large portfolios?	5	3	4
Has the Bidder demonstrated that he understands the requirements of the bid and the compliance requirements in terms of Health, Safety, Public responsibility, and Environmental matters?	4	4	2
Does the number of properties, which it is intended to sell on, create significant uncertainty as to the bid value?	3	2	1
Total	**20**	**15**	**13**

Finding: Health Estates were marked lower than the Miller Group consortium in respect of quality of bid and experience of the bidders when, in our adviser's (King Sturge) professional opinion, they should have been marked higher. This difference is not enough to affect the overall ranking of the bidders.

KPMG

18. The second potential conflict of interest raised by Pears arises because KPMG acted as the Miller Group's auditors. Pears further suggested that a member of the KMPG team was a disgruntled former employee of WS Atkins. Related to this is a claim that KPMG evaluated Health Estates' financial structure unfairly.

Auditors of bidders

19. NHS Estates appointed KPMG as financial advisers to the project in May 2001, prior to the commencement of the bidding process. Their general terms of business and terms of the supply of corporate finance services were provided to NHS Estates at that time and these terms outlined the arrangements to minimise the potential for conflicts of interest between the provision of advisory and auditing services. In a letter to the National Audit Office KPMG have given assurances that there are effective Chinese walls in place to separate the consulting and audit functions, specifically that the corporate finance division is physically segregated from the audit areas, and that KPMG comply with the Guidance Notes published by the Institute of Chartered Accountants in England and Wales. In relation to NHS Estates, KPMG also confirmed that the corporate finance team had been led throughout from KPMG's London office, whilst the Miller Group's client service team is based in Edinburgh.

20. KMPG told the National Audit Office that it is a matter of public record that they are auditors of the Miller Group and Halifax (now known as HBOS), and indeed all published company accounts record the name of the appointed auditor. NHS Estates, nevertheless, informed the National Audit Office that they were not initially aware of KPMG's audit relationships with the Miller Group or HBOS.

21. It is difficult in a situation where there are likely to be several bidders in a transaction, each with their own auditors, to prevent potential conflicts of interest arising. The nature of corporate finance activities is so wide ranging that a number of the threats to objectivity of the adviser can arise when providing corporate finance advice to both audit and non-audit clients. There is little guidance available from supervisory bodies for this particular situation.

22. Although the KPMG partners concerned are situated in different locations and have separate reporting lines it would have been prudent for an adviser in these circumstances to write to the client with details of potential conflicts as and when this came to their attention. KPMG do not accept that the provision of corporate finance advice to a client about a bid from a business that they audit constitutes a conflict of interest.

23. KPMG told us that they provided Robson Rhodes, who audited the bid evaluation process on behalf of NHS Estates, with a list of existing audit relationships on 19 June 2002, when four bidders were still in the competition. Robson Rhodes then provided NHS Estates with a list of KPMG's audit relationships connected with this transaction. The Robson Rhodes' list was helpful. We also note that KPMG discussed with NHS Estates the Miller Group's request that they provided tax advice in relation to the Miller Group consortium bid. NHS Estates gave written clearance for KPMG to act for the consortium in this capacity, subject to normal

Chinese walls being in place. We consider the onus should nevertheless be on the adviser, not a third party, to disclose potential conflicts which, in our view, encompasses advising a client about a bidding process in which another client is taking part. We also consider it would be good practice for departments to be proactive in seeking information about potential adviser/auditor conflicts and to consider the implications.

24. Pears linked this concern to the issue of financial evaluation of the bidders (see paragraphs 28-35 below).

> **Finding:** KPMG are auditors to both the Miller Group and HBOS. They are also an adviser to NHS Estates on a deal in which both Miller and HBOS are one of the key bidding consortia. KPMG have structures and procedures in place to act as Chinese walls between audit and corporate finance functions, to minimise potential risks from conflicts of interest.
>
> There is no evidence of failure in the procedures to separate the audit and corporate finance functions in this instance or that a breach occurred. It follows that there is no evidence that KPMG's role as auditors of Miller and HBOS had any effect on the financial evaluation of the bidders conducted by KPMG Corporate Finance.
>
> We consider it good practice for advisers on PPP deals to write to clients as soon as they become aware that an audit client is a bidder. In addition, in our view NHS Estates should have been proactive in seeking information about adviser/auditor conflicts.

Former Employee of Atkins

25. Pears suggested that a former employee of Atkins, who was a member of the KPMG bid evaluation team, left Atkins on bad terms, and that this resulted in bias in the evaluation of bids. The National Audit Office discussed this with the individual concerned who informed us that he had left Atkins on 20 September 2000, following a restructuring programme, which led to his redundancy, and joined KPMG Consulting on 1 December 2000. He was included as a junior member of the four-man KPMG financial evaluation team on 8 May 2002, some nineteen months after he left Atkins. He told the National Audit Office that he considers that he left on good terms. The National Audit Office also discussed this with Atkins who support fully the individual's assertion that he left on good terms and that they maintain a good relationship with him.

26. In this instance it is hard for us to determine the extent of influence that a junior member of staff may have had within the KPMG financial evaluation team. KPMG assure us that he did

not play a leading part in the decision making process. Pears has said that he did play a leading role and that his name was on many e-mails that it received. If this had been a major concern at the time we would have expected Health Estates to have asked NHS Estates or KPMG to remove him from the evaluation team when they became aware of his involvement. Pears told us that they only found out about his connection with Atkins after the preferred bidder was chosen.

27. This issue is an important one to understand and resolve as Pears linked it to the issues contained in paragraphs 28-35 below about KPMG's analysis of the BAFOs.

> **Finding:** Atkins, Pears' bidding partner, do not support Pears' concern that a former employee of Atkins, who was a member of the KPMG bid evaluation team, left Atkins on bad terms. Both Atkins and the individual concerned have told us that they consider the relationship to be a good one. The work carried out by the National Audit Office described below found no evidence of bias in the evaluation of the bids by the individual employed by KPMG.

Health Estates' financial structure

28. Pears suggested that Health Estates' proposed financing structure was unfairly evaluated, particularly as it received feedback from NHS Estates that Health Estates' use of on-balance sheet corporate financing was considered less acceptable than a heavily debt-financed non recourse special purpose vehicle.

29. The ITN set a pass/fail criterion for financing and both short listed bidders passed this test at the ITN stage. On several occasions NHS Estates told the National Audit Office and the Department of Health that this pass/fail criterion was also applied to the BAFO stage.

30. KPMG told us that they evaluated the financing structures at BAFO stage on a qualitative basis, with the key issues being price and deliverability. At the time of the final evaluation KPMG produced two reports. Report C was their final report on the final evaluation of all four short listed bidders and incorporated information available up to June 2002. Report D was an evaluation of the two BAFO contenders. Both of these reports were dated 28 August 2002. KPMG e-mailed Report D to NHS Estates on the afternoon of 27 August, the day before the Steering Group was to make its decision on preferred partner. A draft of Report C had been available to the Steering Group for some weeks ahead of the meeting.

31. NHS Estates themselves produced the Draft Bid Evaluation Report dated 28th August 2002 used by the Steering Group to make the selection and contain the following comments.

> " The review of financial robustness indicates a greater level of certainty over availability of funding with the Miller/HBOS consortium. This appears to reflect:
>
> (i) The greater experience of Miller through PFI in terms of understanding the requirements of the public sector, and the presence of a banking partner in the consortium
>
> (ii) The intention of Pears to sell on sites quite quickly, which led them initially not to seek to clarify longer term financing arrangements until they were pressed to do so."

32. Neither of the reasons at (i) & (ii) are evidenced in the KPMG financial evaluation reports. The KPMG evaluation report C is particularly critical of on-balance sheet structures. This is the report that NHS Estates used when putting together their own evaluation report. It was also relied on by the Steering Group as part of the evaluation without further explanation by KPMG. Health Estates and another bidder, Health Property Solutions, initially proposed on-balance sheet financing structures. Health Estates' proposals moved on and their BAFO bid involved the use of a special purpose vehicle in response to KPMG's criticisms of their original structure. This would have been financed by Pears providing the entire funding for the transaction from its own resources and funding facilities. The special purpose vehicle was to be guaranteed by Pears.

33. In a meeting with the National Audit Office in December 2002 KPMG explained the reasons behind the comments in Report C. Throughout the BAFO process KPMG and NHS Estates considered that Pears' bid financing lacked clarity and certainty. They could not, for example, establish the certainty of the funds being available when needed. KPMG told us that, as is their normal practice, they went to great lengths to assist Health Estates, and Pears in particular, to put forward an acceptable financing package. They gave Pears extra time, for example, to produce draft term sheets from banks. They insist that their Report C was not meant to be critical of particular structures, but of the lack of certainty and clarity of the financing. Their impression was that the Miller Group consortium were more engaged and had done a lot more work on financing than Pears, producing higher quality proposals. KPMG's Report D did not contain the criticism of on-balance sheet structures that was in Report C.

34. NHS Estates have said that although committed finance was not required as part of the bid submissions they had expected detailed term sheets and a thorough level of understanding of the nature of the risks associated with the various types of developments that were likely to be undertaken.

35. We have seen a draft term sheet provided by Deutsche Bank (Pears' bank) and submitted to NHS Estates on 14 August 2002 for a facility of £150 million - £180 million. We have also

seen a draft term sheet provided by the Miller Group consortium which was more detailed and contained more conditions than the Pears' terms sheet. This is what we would have expected given that the Miller Group consortium were proposing a non-recourse structure whereas Pears proposed to issue a guarantee to its special purpose vehicle.

Finding: KPMG's Report C was critical of on-balance sheet financial structures of the sort initially proposed by Health Estates and another bidder. This report was one of several documents relied on in the evaluation of the bids by NHS Estates. KPMG's Report D did not contain this criticism but was only available on the afternoon before the decision was taken.

The criticism in Report C would not, however, have affected the overall ranking of the bidders. This ranking, on the basis of NHS Estates' financial evaluation, stood up to scrutiny from the National Audit Office.

The Evaluation of Health Estates' Best and Final Offer

36. Health Estates submitted their best and final offer bids on 8 August 2002. As well as making bids which complied with the four models proposed in NHS Estates' guidelines for Best and Final Offer bids, Health Estates made a further variant bid alongside their compliant bids. This included a profit share scheme for the development of a specified number of sites within the overall estate. Pears suggested that its bid was not given sufficient consideration and that confidential details of it were shared with the other short listed bidder without Health Estates' permission.

Evaluation of Variant Bid

37. After taking legal advice, NHS Estates considered the fifth, "variant", bid submitted by Health Estate to be non-compliant with their guidelines for submission of bids. They believed they had two options: to reject this bid totally; or to help the bid become compliant. NHS Estates recognised that this non-compliant bid had certain merit in that it offered potential for extra revenue but that it also carried some degree of risk. They decided to seek further particulars of the variant bid from Health Estates and, "at the same time disclose to Miller/HBOS consortium the fact that such a bid had been made, outlining the broad nature of the variant bid, in order to allow the consortium the opportunity, if they were so minded, to put up a variant proposal along similar lines".

38. The variant bid involved the early selling of sites to joint ventures formed with house builders. NHS Estates would then share in the profits realised by the final sale of the developed

properties. At the time of the evaluation, many key details were still unknown, such as the joint venture partners and including the detailed terms of the agreement between all the parties. Pears told us that it had letters of support from two major house builders which it submitted in support of its variant bid. The unknowns represented a risk that was difficult to quantify. Given the risks, including of a significant possible delay to the timetable, NHS Estates chose to proceed with the evaluation on the basis of the compliant bids:

> "Given the speculative nature and level of risk involved, together with the fact that eliminating the uncertainties might involve a significant delay to the financial close of the PPP Project, NHS Estates preferred to consider such arrangements as an option rather than being compelled to enter into the Joint Ventures later upon uncertain terms."
>
> (Extract from NHS Estates Draft Bid Evaluation report of 28 August 2002)

39. NHS Estates, however, made provision in the draft contract with the Miller Group consortium for progress to be made on profit sharing if it was in the interest of the public sector. They took this approach because partnership working inevitably meant choosing a partner before the detail was settled and they envisaged difficulties in maintaining the interest of bidders if there had been a competitive process in relation to the profit sharing/joint venture idea. In our view it would have been sensible for NHS Estates to have allocated more time – possibly only 2-4 more weeks – to clarify each bidder's approach to profit sharing/establishment of joint ventures, including the potential extra financial benefit to the public sector that each was prepared to offer. The problem of deciding to explore such a different approach after a partner was chosen was that there was not necessarily any clear understanding of each side's expectations and no commitment to offer any particular return to the public sector, even if the concept itself was acted on.

> **Finding:** Where, as in this case, variant bids are allowed for value for money reasons they should be considered seriously. NHS Estates gave serious consideration to the concept of profit sharing/joint ventures with house builders but decided not to pursue it further at that stage. They decided to take the concept forward with the preferred bidder. The preferred bidder was chosen on the basis of standard bids. Best value is, however, likely to be achieved from negotiations which are undertaken when there is competition between bidders. A few more weeks' negotiation on a variant option could have been useful and, in our view, would not have been likely to result in the bidders withdrawing, although they may have found it frustrating.

Sharing of Details

40. The second aspect of Pears' complaint about NHS Estates' treatment of the variant bid was the level of detail shared with the Miller Group consortium. The ITN contained the following paragraph:

> "No disclosure will take place of the details of confidential information, offered by the Bidder during negotiations. SoSH reserves the right to disclose general information, including Bidder consortia members and contact details, and that the more acceptable terms may have been offered to him and the nature of such other terms (including price) and why they are more acceptable ".

41. NHS Estates' legal counsel judged their actions to be legally permissible. The opinion states the following sequence of events:

Figure 2 Sequence of events identified by legal counsel

Date	Event
12 August 2002	NHS Estates met with Health Estates to gain a better understanding of the variant bid.
14 August	NHS Estates had a telephone conversation with a member of the Miller/HBOS consortium "in general terms" about the Health Estates' variant bid and agreed to put this topic on the agenda for the scheduled meeting with them on 16 August.
16 August	At the meeting with Miller/HBOS there was a fairly broad ranging discussion of profit sharing. NHS Estates explained the point at which the profit sharing scheme would come into operation and that it would involve the bidder entering into a profit share with a house-builder who would obtain specified sites for a low price. The risks and possible rewards of such profit sharing were discussed in broad terms, and NHS Estates observed that risk might be reduced if house-builder costs were fixed at the outset. NHS Estates invited the Miller/HBOS consortium to review a number of sites and ascertain which of the sites might be appropriate for profit sharing. NHS Estates also indicated that it was looking to obtain a commitment from the bidder to explore the option of profit sharing.
16 August	At the end of the day NHS Estates sent an e-mail to Health Estates stating that they believed the variant bid was non-compliant, but that they had to pursue their investigations by being fair to both bidders. They proposed to evaluate the bid and to meet them on 19 August to discuss the structure further.
19 August	NHS Estates met with Health Estates and discussed, inter alia, the variant bid. At this meeting NHS Estates asked Health Estates for their permission to share details of their variant bid with Miller/HBOS.

42. The Health Estates team could not confirm that they were able to agree to the request to share details of their variant bid at the 19 August meeting. NHS Estates had a telephone

conversation with Mr Pears, Managing Director, later that day and maintain that Pears agreed to NHS Estates' request to share information with the Miller Group consortium. Pears is adamant that it did not agree to the NHS Estates' request. This conflict of opinion as to whether or not there was agreement by Pears to the NHS Estates' request remains unresolved.

43. NHS Estates agree that they sought Health Estates' agreement to share details of their bid with the Miller Group consortium after they had already spoken about the bid, twice, with the consortium. It is common practice to ask bidders to reconsider parts of their submission in the light of proposals from other bidders. Ideally at such a crucial stage in this process the request to Pears for permission should have been made in writing and a written response obtained.

44. It is difficult to be precise as to the interpretation of "general information". As a benchmark NHS Estates' legal counsel identified that, in his opinion, a profit sharing scheme could hardly be termed an innovative idea and, in his opinion, it would be one that would be well known to the industry. The National Audit Office tasked King Sturge to review the variant bid proposed by Health Estates. They considered that although the exact approach appeared to be original, a number of developers are prepared to share extra profits with PFI/PPP-type partners through a range of mechanisms. King Sturge did not consider Health Estates' proposal to be ground breaking. Pears told us that in its opinion, in the context of this particular transaction, its proposed approach was novel.

45. We consider that NHS Estates would have been within the interpretation of "general information" if they had merely disclosed that the variant bid was a profit sharing scheme with a house-builder that had been applied to a selection of properties within the estate. It is not clear from the note of NHS Estates' meeting with the Miller Group consortium on 16 August precisely how much information was disclosed. NHS Estates told us that only generic information (aimed at understanding at what price land would be transferred, public sector exposure to construction risk and the profit sharing amounts to be secured) was disclosed to allow comparisons to be made between offers.

Finding: The appropriate level of bid detail to be shared with the Miller Group consortium is not a straightforward judgement. The Secretary of State for Health had reserved the right to disclose general information. We consider the outline of the variant bid to amount to general information. It was not good practice to ask for permission to share information after it had already been shared.

46. In the light of our findings on the evaluation of Pears' experience and financial structure we decided to examine the overall evaluation methodology and its application. We examined the

scoring of the property bids, the unadjusted results, the application of the "confidence factor" and adjustments for possible "legal risk".

Confidence Factor

47. Each property bid was made up of two parts: an initial payment, made at deal closure, and a further payment received in the future once the site was developed and sold (overage). The confidence factor was part of IRE's property evaluation. IRE told us that the detailed mechanism of the confidence factor was designed by NHS Estates and approved by a property group comprising property professionals from NHS Estates, IRE and the District Valuer. The confidence factor aimed to moderate the values of the overage payments received from the bidders to correct the tendency of the bidders to bid up the value of their overage payments. As the markings to which the confidence factor is applied already reflect the achievability of each proposal (Figure 3) we conclude that the use of the confidence factor effectively resulted in adjustments for realism being applied twice.

Figure 3 Property Scoring Questions

The property scoring questions weighted the proposals in terms of achievability.

	Question	Max. % Score
1	Does bidder's assessment of Highest and Best Use Value appear achievable and credible? (Highest mark for a credible scheme producing equal or better value than NHSE's assessment)	16
2	Does NHSE agree with the main assumptions of the development appraisal? (This question should receive no marks if the proposal is considered not feasible at all)	16
3	Is planning permission for the proposed development likely?	16
4	Is the timing and strategy for obtaining planning permission credible?	10
5	Is the timing and strategy for obtaining vacant possession credible?	7
6	Does the bidder have a credible strategy for dealing with any encumbrances?	8
7	Has the bidder made a reasonable quantification of development risks?	4
8	Does the project plan demonstrate an informed and structured approach to the development?	3
	Total Score	80

48. The evaluation before the application of the confidence factor rated Health Estates higher than the Miller Group consortium in a larger number of properties. The higher confidence factor of the Miller Group consortium appears to have arisen from a high score on particularly high value properties. There is scope for its use to lead to counter intuitive results – the example we developed below shows one possible oddity:

Figure 4 Example Confidence Model

This example shows that, hypothetically, a bidder could offer less overage and achieve lower marks but still gain a higher confidence factor and overage value.

Overage		Weight	Mark		Confidence (%)	
Example bidder 1	Example bidder 2	(%)	Example bidder 1	Example bidder 2	Example bidder 1	Example bidder 2
30	25	8.46%	40	35	4.23%	3.70%
30	25	8.46%	40	35	4.23%	3.70%
30	25	8.46%	40	35	4.23%	3.70%
30	25	8.46%	40	35	4.23%	3.70%
30	25	8.46%	40	35	4.23%	3.70%
30	25	8.46%	40	35	4.23%	3.70%
30	25	8.46%	40	35	4.23%	3.70%
30	25	8.46%	40	35	4.23%	3.70%
30	25	8.46%	40	35	4.23%	3.70%
30	25	8.46%	40	35	4.23%	3.70%
30	70	15.38%	20	60	3.85%	11.54%
330	320	100%	420	410	46.15%	48.56%
Overage value					152.31	155.38

49. The National Audit Office tasked King Sturge to review the operation of the confidence factor. They concluded that the scoring by IRE of the proposals for specific properties appears to be broadly consistent and in line with/compatible with their professional judgement.

Finding: In our view, and that of our advisers, the use of the confidence factor added to the complexity of the evaluation and made it less transparent. We saw no clear justification for it over less complex procedures.

Legal Risk Adjustment

50. As part of the Bid Evaluation methodology adopted by NHS Estates an evaluation was made of changes requested to the standard documentation where this involved additional risk to the Department of Health. These risks are separate from the risks associated with the property proposals and arise from the bidders' suggested contract changes. This evaluation resulted in risk ranges for each of the bidders. These are shown below. In the evaluations NHS Estates chose to use the maximum value in each range as a risk deduction from the value of each bid.

NHS Estates then incorrectly applied the confidence factor to the legal risk regarding property. This resulted in a positive impact on the evaluation of the bid from the Miller Group consortium, which had the larger legal risk adjustment, compared to the Health Estates' bid.

Figure 5 Legal risk adjustments

Legal risk adjustments were calculated based on the modifications the bidders wished to make to the standard legal documentation.

Legal Risk Adjustments	Health Estates	Miller Group consortium
Estates Property		
Initial payment (£m)	0-11	0-11
Overage (£m)	0-3	0-10
Inventures		
Legal risk (£m)	0-2.5	0-0.5

51. We conducted a sensitivity testing of the evaluation of the bids for the property to see how it stood up to scrutiny. The results are shown in figure 6 below. The sensitivity tests showed that the Miller Group consortium's 50% overage bid still offered the highest value.

Finding: Sensitivity testing by the National Audit Office of the property bids, on the basis of the most favourable assumptions for the Pears' bid that the National Audit Office could justify, showed that a bid from the Miller Group consortium was higher than Pears' bids.

Figure 6 Result of the sensitivity testing of bids for the property

Taking into account the findings of our advisers and our own analysis, we show the value of the property bids on the basis of the most favourable assumptions for the Pears' bid that our analysis could justify.

Payment Streams	Health Estates		Miller Group consortium	
	50% Overage	60% Overage	50% Overage	60% Overage
Contractually certain				
Initial Payment (£m)	239	194	208	170
NPV of Guaranteed Overage (£m)	30	41	63	34
Less Legal Risk Adjustments (£m)	(11.00)	(11.00)	(11.00)	(11.00)
NPV Certain Payments	**258**	**224**	**260**	**193**
Overage Payments				
Unguaranteed overage (£m)	184	240	231	333
Confidence Factor (%)				
Property (Score weightings)	43.9%	43.9%	40.8%	40.8%
Technical	15.0%	15.0%	13.0%	13.0%
Total	58.9%	58.9%	53.8%	53.8%
NPV of Adjusted Overage (£m)	108	141	124	179
Less Legal Risk Adjustments (£m)	(3)	(3)	(10)	(10)
Risk Adjusted Overage	**105**	**138**	**114**	**169**
NPV Risk Adjusted Bid Price	**363**	**362**	**375**[1]	**362**

[1]**Note:** Due to rounding figures may appear not to add up

Source: King Sturge, NHS Estates

The influence of Inventures' management on the bidding process

52. Both short listed bidders bid for the surplus property and Inventures. Pears' claimed that it was encouraged to increase its bid for Inventures at the expense of the property element. It said that this had a disproportionate impact on the total value of its bid – possibly by up to £3 million. As this encouragement was made orally there is no supporting information. Pears also had concerns about the influence of Inventures' management on the decision making process,

referring in particular to the formal Minutes of the Steering Group meeting of 28 August 2002. These identify Inventures' Chief Executive and Chief Operating Officer respectively as being present at the meeting which took the decision to appoint the Miller Group consortium as preferred bidder. Inventures' Chief Executive had previously been Chief Executive of NHS Estates.

The implications of a higher bid for Inventures

53. At 10 June 2002 both bidders had bid £1 million for Inventures. On 5 July 2002 Health Estates bid £5 million and the Miller Group £2.5 million. So this is not inconsistent with the claim that Pears had been encouraged to bid higher for Inventures. It is not clear that this increased bid for Inventures was at the expense of their property bid as the bid for the estate also increased (on the basis of the 60 per cent overage and no rent bid). The Miller Group consortium told us that they had been asked to increase their bid for Inventures but not at the expense of the property bid.

54. It is not obvious why NHS Estates would want a higher value for Inventures at the expense of the property. Pears believed that Inventures management may have stood to gain from a higher value and influenced NHS Estates, although Pears was not in a position to have evidence to support this. NHS Estates did at one point consider offering Inventures' management a bonus, to reward them for a difficult year, out of the proceeds of the sale. At the 28 August 2002 Steering Group meeting NHS Estates referred to the possibility of transferring bonus monies to a fund from which the successful bidder could award shares to employees. These proposals were not taken forward and were replaced by a proposal for a performance related bonus scheme to be paid out of profits earned by Inventures.

Attendance at Steering Group meeting

55. Discussion with the Department of Health Chief Internal Auditor and other parties who were present at the 28 August Steering Group meeting indicate that the meeting was in two parts, as previous Steering Group meetings had been. The Chief Executive and Chief Operating Officer of Inventures had no formal role in the evaluation but attended the first part of the meeting and left before the second part started. The purpose of the first part of the meeting was to give Inventures' management an opportunity to offer views of the two bidders as potential employers. Inventures' management stated that they would be happy to work for either bidder; however on balance their preference was for the Miller Group consortium as it appeared to them to offer more certainty of career structure and independence. This is consistent with evidence from our interviews with Inventures and the Miller Group in which the preference of

Inventures' management for being managed as a separate business by the Miller Group consortium, rather than becoming part of Atkins' healthcare business, became evident.

56. NHS Estates' bid protocols forbade un-chaperoned meetings between Inventures and bidders. Inventures' management told us that there had been some informal contact with all bidders – telephone conversations, meetings on Industry working groups or social events. Inventures have no written record of such contact. Atkins showed us manuscript notes of some conversations during a meeting with them. Neither bidders' proposals for Inventures' business and remuneration policy were clear at this stage. Neither bidder gave details of specific benefits that would be available. During our June meetings with the Miller Group and Inventures it was clear that remuneration had not been settled. On the evidence available, Inventures' management could not, therefore, have known whether they would have benefited more financially from a deal with the Miller Group consortium than from a deal with Health Estates.

> **Finding**: Inventures had no formal role in the evaluation. The evidence available indicates that as at June 2003 there was no agreement on personal terms between Inventures and the Miller Group consortium. It was not good practice for Inventures' management to have had unrecorded conversations with bidders. It would have been good practice for Inventures' management to have notified NHS Estates of any contact with bidders, even of an informal and unanticipated nature, when it occurred and the content of any discussion.

Post decision process

Arrangements for selection of preferred bidder

57. NHS Estates sent requests for BAFO submissions to the two selected shortlisted bidders on 26 July 2002. Bidders were required to submit their BAFO by 3.00 pm on 8 August 2002. The guidance stated that no official announcement of preferred bidder would be given before 28 August. It was NHS Estates' intention to notify bidders of the identity of the preferred bidder prior to this date following which (and prior to 28 August) NHS Estates intended to enter into a Heads of Terms agreement with the identified bidder.

58. On 16 August NHS Estates sent an e-mail communication to Pears confirming that the process for preferred bidder selection would be to evaluate the BAFOs, to meet with bidders for discussion and to provide informal notification to both bidders of intentions with regard to preferred bidder during the week commencing 26 August; and to obtain Steering Group ratification of the selection on 9 September 2002.

59. NHS Estates told the National Audit Office that the overall sequence in the process was maintained, but the actual dates were pushed back by need to give bidders an opportunity to talk about variant bids, then to prepare papers for board decision. So the Steering Group made a selection of preferred bidder on 28 August subject to achieving successful Heads of Terms. Pears was informed by phone of this decision on 29 August which was acknowledged by Pears in an e-mail on the evening of 29 August. Pears were notified in writing on 3 September by NHS Estates. At that time NHS Estates aimed to achieve Heads of Terms by 5 September. In the event it took slightly longer to achieve Heads of Terms and the deal was officially announced on 11 September.

60. After receiving the acknowledgement from Pears on 29 August NHS Estates had an oral debrief with them. NHS Estates did not provide written feedback except in the way of responses to complaints subsequently raised by Pears from 5 September onwards. The National Audit Office has not found any reference to a promise of formal written feedback within the BAFO request or guidance.

61. NHS Estates confirmed to us that at the time of the Steering Group's decision on 28 August there were issues outstanding, and that they were material issues in that they needed to be agreed before the final Heads of Terms could be signed. These outstanding issues did not, however, throw doubt on the outcome of the preferred partner decision. They were contractual points that had to be cleared up.

> **Finding:** NHS Estates informed Pears by phone of the decision to appoint the Miller Group consortium as preferred bidder on 29 August. NHS Estates informed the National Audit Office that they provided an oral debrief to Pears shortly after receiving an e-mailed acknowledgement to NHS Estates' phone call on the 29 August. NHS Estates did not provide written feedback on the process except in the way of responses to complaints subsequently raised by Pears from 5 September onwards. The National Audit Office has not found any reference to a promise of formal written feedback within the BAFO request or guidance.
>
> NHS Estates followed the sequence of events stated in the BAFO request. In the event the timetable for achievement of milestones was delayed. At the time of the selection of preferred bidder on 28 August there were contractual issues outstanding which needed to be cleared to achieve successful Heads of Terms. These issues were typical for that stage in the process rather than potentially putting the preferred partner decision in doubt.

Due diligence

62. Pears alleged that the Miller Group consortium only undertook substantial due diligence work on the property portfolio, such as querying legal title on properties, after they were appointed preferred bidder and that this should have been done earlier. Pears said that they had completed and priced all due diligence as part of their BAFO submission. Pears believed that in allowing the Miller Group consortium to proceed with further due diligence NHS Estates were acknowledging that there were material issues still outstanding which needed to be resolved before the deal could be completed, and that this was unfair to Pears.

63. NHS Estates confirmed to the National Audit Office that the Miller Group consortium had continued to undertake some due diligence work, but that this work was not to rectify inadequate due diligence at bidding stage or with the aim of improving or in other ways materially changing the basis of their bid. NHS Estates said the work was aimed at verifying particular details of some properties and was of the nature of that expected of a purchaser of a property shortly prior to taking up the final deeds.

> **Finding**: The Miller Group consortium continued to undertake some due diligence work after being appointed preferred bidder. NHS Estates informed us that the level of such work is only what they expected during the period before handover of property to a new buyer.

Glossary

Atkins, WS Atkins	Member of the unsuccessful shortlisted consortium bidding for NHS Estates PPP
BAFO	Best and Final Offer
Inventures	Consultancy firm, part of the NHS Estates' PPP
IRE	Insignia Richard Ellis, property advisers to NHS Estates
ITN	Invitation to Negotiate
KPMG	Financial advisers to NHS Estates
King Sturge	Property advisers to the National Audit Office
The Miller Group consortium	Miller Group and HBOS (Halifax and the Bank of Scotland), the successful bidder for NHS Estate's PPP
PPP	Public Private Partnership
The Pears Group	William Pears, member of the unsuccessful shortlisted consortium bidding for NHS Estates' PPP
Robson Rhodes	Financial advisers to NHS Estates