

Highways Agency

Procurement of the M25 private finance contract

Appendices Four to Seven

Contents

Appendix Four

Delays to the procurement of the
M25 contract **3**

Appendix Five

Features of the Payment Mechanism **4**

Appendix Six

Contract management **6**

Appendix Seven

Scope and detailed methodology **8**

Appendix Four

Delays to the procurement of the M25 contract

Figure 1

Reasons for the delay

The project was approved in 2003 with construction expected to start in May 2007. The preparation of the procurement took around nine months longer than the Agency expected. The procurement set out below then started in September 2005.

	Date forecast in May 2005	Actual date	Variance (months)	Total variance (months)	Reasons
Notice in the Official Journal of the European Union	September 2005	November 2005	1.5	1.5	The Agency had difficulty agreeing handling of the demand management project.
Prequalify bidders	January 2006	March 2006	0.5	2	
Issue Invitation to Submit Outline Proposal	January 2006	April 2006	1	3	The Agency had not used this stage before.
Shortlist bidders	June 2006	October 2006	0.5	3.5	The Agency carried out extra review to ensure the process had not been biased against rejected bidders.
Issue tender documents	August 2006	March 2007	3.5	7	The Agency had difficulties finalising complicated tender schedules.
Identify Provisional Preferred Bidder	August 2007	May 2008	2	9	Limited rebid required after all three bids were non-compliant. Announcement delayed by local elections.
Award contract	February 2008	May 2009	6	15	Difficulties arranging funding during the credit crisis.
Construction work begins	May 2008	May 2009	-3	12	Construction started at contract award.
Service begins	May 2008	September 2009	3.5	15.5	Service commencement delayed to ensure service could be covered by existing contractors.

Source: Highways Agency

Appendix Five

Features of the Payment Mechanism

The Agency's objectives include improving reliability and reducing congestion; informing travellers; and improving road safety. The payment mechanism is closely aligned with these objectives. It comprises six elements, providing incentives to meet the Agency's requirements (**Figure 2**). Two elements of the payment mechanism, the road condition and the route performance indicators, are not yet operational, as was agreed under the contract. They become operational at six and 18 months respectively as appropriate data become available.

Figure 2
Incentives in the payment mechanism

Element of the payment mechanism	Incentive	Consequences of performance above or below requirements
Lane availability	Undertake maintenance at times that minimise delays.	Deduction if traffic flow is reduced by closed lanes, narrowed lanes or temporary speed limits. This is the most significant element.
Road condition	Maintain the road in a safe and serviceable condition.	Deductions.
Route performance	Reduce travel time and improve travel time reliability.	Deductions or bonus depending on performance.
Safety performance	Reduce the number of people killed or seriously injured.	Deductions or bonus depending on performance.
Unplanned event management: <ul style="list-style-type: none"> • Exceptional circumstances • Critical incident management 	Keep the road running and avoid congestion.	<ul style="list-style-type: none"> • Deduction made if traffic cannot leave a main carriageway section and users suffer severe inconvenience. • Bonus or a deduction depending on whether it re-opens the road within a two hour target.
Proactive management bonus	Continuous improvement.	Bonus if Connect Plus has been proactive in working with the Agency to deliver developing project objectives.

Source: National Audit Office analysis of Highways Agency data

The Agency manages other elements of Connect Plus's performance by awarding performance points if Connect Plus breaches any of its obligations under the contract. The contract sets out the number of performance points to be awarded for different types of breach, such as simple administrative failures, safety infringements, or lack of openness and honesty. Connect Plus suffers consequences from accumulated points, from additional monitoring at 500 points, to loss of proactive management bonus at 600 points, to termination at 5250 points (until completion of construction after which the threshold falls to 3500 points). At the end of June 2010 the Agency had raised over 600 points although many of these were being challenged by Connect Plus. The Agency has used the points system on previous private finance contracts, and found it an effective system, with lenders monitoring performance points.

Appendix Six

Contract management

1 The Agency's contract with Connect Plus, entered into in 2009, was for 30 years. It is important that the Agency has effective contract management procedures to ensure that the value that the Agency hopes to derive from the contract is not eroded over this long period.

Performance to date

2 The Agency allowed Connect Plus time to adapt to the contract, but then found that the initial reporting of performance by Connect Plus had been poor. Staff from the contractors previously managing the M25 have had some difficulties in adapting to working on the M25 under a performance-driven contract. Connect Plus responded to identified issues. It is thoroughly reviewing the contract and has identified over 4000 obligations, reflecting the complexity of the contract. It also made changes to senior management in Connect Plus Services.

3 There has, however, been a generally smooth transition from the previous service providers. After one year of service, there has been no significant failure of service to the public in terms of safety, network availability or financial control. The performance mechanisms have contributed to the performance achieved.

Risks to managing the contract

4 The Agency faces various risks in managing the contract:

- **Appropriate skills:** in August 2008, the Agency concluded that it had the right commercial skills to manage a contract of this size, as it has general experience of managing private finance contracts. However the team managing the contract has generally transferred from managing the M25 under conventional contracts and has limited experience of managing private finance contracts.
- **Transfer of knowledge from advisers:** in November 2006, the Agency let a six year contract to Hyder Halcrow Joint Venture for support on the M25 contract, extendable for up to six years. The Agency has a budget of around £5 million a year for this support. The Agency expects to reduce its reliance on Hyder Halcrow over time, although it plans to have adviser support throughout the life of the contract. It is developing plans to transfer knowledge and information.

- **Governance arrangements:** in July 2007, Metronet, set up to modernise London Underground, went into administration.¹ Two of its shareholders, Balfour Beatty and Atkins, are Connect Plus shareholders and key contractors. The Agency has put in place governance arrangements to address the key lessons from Metronet. Given the risks from shareholders who are also contractors, the Agency will need to monitor how well the governance arrangements work.
- **Information to manage the contract:** in response to the failure of Metronet, the contract contains detailed information rights including access to information on financial performance. The Agency is receiving ongoing information from Connect Plus but had not obtained the equivalent independent reports from the banks' advisers to which it was contractually entitled. The Agency was unaware of its contractual entitlements on information, only requesting information from Connect Plus when we asked for it. The Agency should improve its approach to contract management, ensuring it obtains and uses information to which it is contractually entitled, particularly information on Connect Plus's financial position. This should be used to monitor risks to Connect Plus's ability to deliver the required services.
- **Performance:** The Agency must continue to use its contract mechanisms to address poor performance. These include a comprehensive set of performance standards and service requirements, quality assurance systems and governance arrangements including an Agency observer on the Connect Plus Board.

¹ We reported on this in *The Failure of Metronet*, HC 512, June 2009.

Appendix Seven

Scope and detailed methodology

Scope

1 This report focuses on the Agency's decision-making, to assess whether it has procured a value for money solution to congestion and poor journey time reliability on the M25. The Agency had to make a number of key decisions leading up to the award of the contract, including:

- whether to deal with congestion through road widening or hard shoulder running;
- whether to use private finance or conventional procurement; and
- whether to let the contract during the credit crisis.

2 We used three value for money criteria in our assessment:

- Did the Agency consider all options and select a value for money solution in deciding to widen the road using a private finance contract (Part One)?
- Did the Agency manage the procurement of the deal effectively (Part Two)?
- Did the Agency give appropriate consideration to alternative solutions (Part Three)?

3 The report makes recommendations to the Agency and also identifies lessons for other departments.

Methodology

4 We used five main methods in researching this report:

- Document review
- Semi-structured interviews
- Financial analysis
- Highways Agency Internal Audit Function
- Benchmarking

Document review

5 We examined academic literature and reports by organisations relevant to the Highways Agency and its management of the road network to obtain an understanding of the sector and to direct other methodologies. We also referred to published transport statistics.

6 We reviewed a range of the Agency's documents (**Figure 3** overleaf). The Agency sourced many of these documents through its advisers.

7 We reviewed previous NAO publications, including associated working papers, relevant to the highways sector and on the use of private finance, including:

- *Department of the Environment, Transport and the Regions: The Private Finance Initiative: The First Four Design, Build, Finance and Operate Roads Contracts*, HC 476, January 1998.
- *Tackling congestion by making better use of England's motorways and trunk roads*, HC 15, November 2004.
- *Improving the PFI tendering process*, HC 149, March 2007.
- *Estimating and monitoring the costs of building roads in England*, HC 321, March 2007.
- *The Procurement of the National Roads Telecommunications Services*, HC 340, April 2008.
- *The Failure of Metronet*, HC 512, June 2009.
- *Highways Agency: Contracting for Highways Maintenance*, HC 959, October 2009.
- *Delivering multi-role tanker aircraft capability*, HC 433, March 2010.
- *Financing PFI projects in the credit crisis and the Treasury's response*, HC 287, July 2010.

Semi-structured interviews

8 We carried out semi-structured interviews between January 2010 and June 2010 with key members of staff within the Agency, the Department, the Agency's advisers, Connect Plus and the bidders (**Figure 4** on page 11):

Figure 3
Review of key Agency documentation

Key documents

Orbit: transport solutions around London, Kellogg, Brown and Root, October 2002

The Agency's business cases, supporting option appraisal documents, and Ministerial submissions

Procurement documentation including procurement plans, guidance to bidders, bidder submissions and bidder evaluations

Information on management of advisers, including budgets, costs, and details of their contractual arrangements including the Agency's management arrangements

The M25 contract, derogations from the Treasury standard contract (SOPC), other supporting commercial documents, and the contract manual

Governance documentation, including organisation charts, meeting minutes, change logs, risk registers, approval documentation and lessons learnt

Connect Plus performance information, including monthly performance report, independent adviser reports, Board meeting minutes

Purpose of review

To understand the review of options for solving problems on the M25, leading to the decision to widen with demand management measures. As the key document leading to the Agency's decision to widen the M25, it was important background information and provided details of the options appraisal undertaken on different solutions.

To assess the robustness of the Agency's decisions, in particular:

- to widen in line with demand management;
- to procure the widening works through a private finance contract;
- to widen and continue with the widening rather than using Active Traffic Management; and
- to continue with the procurement when the cost of financing increased during the credit crisis.

To assess the quality of the procurement and the quality of the competition.

To assess the level and nature of adviser support and the adequacy of the Agency's management.

To understand the commercial arrangements and key elements of the contract

To understand the adequacy of governance arrangements and management controls during the procurement phase and arrangements put in place to manage the operational phase.

To assess the early performance during the operational phase

Source: National Audit Office

Figure 4
Semi-structured interviews

Interviewee	Purpose of the interview
Highways Agency procurement team	To understand the procurement and the issues from the Agency's perspective.
Highways Agency operational team	To understand the issues and the performance of Connect Plus during the transition and early operational phase, and progress on the demand management project. This included the Agency's resources including an assessment of training, staff succession planning and knowledge transfer arrangements from their advisers.
Department for Transport	We interviewed various representatives from the Department, including the Corporate Finance team. This was to understand the role the Department played in the procurement, in particular its role in arranging financing during the credit crisis. We also wanted to understand its role in the operational phase of the project, and in the demand management project.
Denton Wilde Sapte (Agency's legal advisers)	To understand the key contractual issues and assess the performance of the Agency during the procurement phase. This included the impact of the financial crisis and the Agency's management of issues arising.
PricewaterhouseCoopers (Agency's financial advisers)	To understand the key financial issues and assess the performance of the Agency in the procurement phase. This included the impact of the financial crisis and the Agency's management of issues arising.
Hyder, Halcrow and the Hyder Halcrow Joint Venture (the Agency's technical advisers)	To understand the key technical issues that arose during the procurement phase and the ongoing role of the advisers in the contract management of the project in the operational phase.
Connect Plus	To discuss the procurement and the operational aspects of the project from the contractor's point of view to aid our understanding of the Agency's management of the project.
Other bidders <ul style="list-style-type: none"> • ALF • FLOW 	To understand the project and procurement issues from a bidder perspective and to assess the Agency's performance.

Source: National Audit Office

Financial analysis

9 We carried out financial analysis to support a number of areas of the report:

- **Decision to use private finance:** we analysed the Agency's comparison of private finance and conventional options for procuring the contract, focusing in particular on two comparisons:
 - the initial decision to use private finance in 2004; and
 - the decision to continue with the procurement during the credit crisis.

- **Bidder evaluations:** we reviewed the work commissioned by the Agency to assess the price of the bids and compare them to the Agency's own estimate of the likely cost of the contract.
- **Costs and savings of Active Traffic Management:** we analysed the works the Agency carried out to estimate the costs and savings of using Active Traffic Management on sections 1 and 4 of the M25. We also derived our own figures.
- **Movement in price between Preferred Bidder and contract award:** we assessed the reasons for the 24 per cent price increase.
- **Refinancing gain share:** we assessed the potential share the Agency could obtain.
- **Spend on advisers:** to understand the pattern of spending on advisers.

Highways Agency's Internal Audit function

10 During our fieldwork, we worked closely with the Agency's Internal Audit function on one aspect of the study. We carried out joint interviews for this work, which was mainly focused on the Agency's governance arrangements for the operational phase of the project. We used Internal Audit expertise to assist in concluding on the Agency's compliance with existing procedures.

Benchmarking

11 We have benchmarked various areas of the Agency's performance, drawing on our knowledge from our study of other PFI projects. The areas benchmarked included:

- Spending on advisers – we referred to our general benchmarking in the report *Improving the PFI tendering process*. We also referred to the Agency's experience on the National Roads Telecommunications Services, and the Ministry of Defense's Future Strategic Tanker Aircraft project.
- Procurement timetable – we referred to our general benchmarking in the report *Improving the PFI tendering process*.
- Financing terms on the M25 contract – we drew particularly on our recent report, *Financing PFI projects in the credit crisis and the Treasury's response*.

12 We also tried to benchmark the costs of the M25 widening to other projects, including other Agency projects and local authority projects. As part of this work, we met with the Audit Commission and a local authority, and reviewed benchmarking the Agency had undertaken with the Dutch. We were unable to obtain comparative data to carry out detailed benchmarking. However, the Agency has recognised the importance of benchmarking, and is likely to carry out work in this area.