

Operational Taskforce Note 1: Benchmarking and market testing guidance

October 2006



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EXECUTIVE SUMMARY

OPERATIONAL TASKFORCE NOTE 1: BENCHMARKING AND MARKET TESTING GUIDANCE

Value for Money in Soft Services Research commissioned by the Treasury has identified public sector concerns about how to manage the processes and outcomes of benchmarking and market testing. This guidance is designed to provide practical advice to contract managers and to encourage the systematic and effective use of these processes, in order to ensure the long-term value for money of soft service provisions in PFI contracts. The terms benchmarking and market testing are collectively referred to as value testing throughout.

Operational Taskforce Note 1 examines a range of issues, which public sector PFI contract managers should consider when approaching a value test. The key issues for consideration are set out below.

Clear Lines of Responsibility Both benchmarking and market testing are primarily the responsibility of the Project Company¹ in terms of cost and management. However, both the Project Company and the Authority must agree on a value for money outcome, and it is essential that the process is open, transparent and inclusive. Users should be kept informed of progress, and adequate time should be allowed for funders' involvement. Roles and responsibilities must be clearly established, and a clear methodology for assessing benchmarking data or evaluating competitive bids must be agreed at the outset.

Early and Thorough Planning Early planning and identification of the skills and resources required for value testing is key to the process, as is maintaining good communications throughout. The process should have a clear plan agreed from the outset, including a timetable that allows adequate time for iteration, clarification and negotiation. It may take anything from nine months to two years to undertake the exercise. Departments should be involved early on in the process, and all appropriate guidance and legislation relating to employee rights must be fully complied with.

Adequate Resourcing Undertaking a value test can be resource intensive. Specialist technical, financial and legal advisors may be required. The Authority should consider the need for advisory support and budget accordingly.

Reviewing the Specification A value test is an ideal opportunity to review the operating specification, and to adjust service levels to better meet an Authority's requirements for the future.

Benchmarking - Ensure Data Provides an Accurate Comparator Both the Project Company and the Authority should independently collect comparative information when undertaking a benchmarking exercise. The Project Company will require this information for identifying a benchmark cost of the services, and the Authority will need it to examine, interrogate and validate the result of that exercise. Authorities must ensure that data used is a valid comparator, transparently compiled. Making accurate comparisons is difficult, and often the data is likely to need to be adjusted to take into account project specific aspects of the service provision, and factors such as regional variations. The Project Company's own costs of providing the services are not a valid comparator.

¹ In this guidance the term "Project Company" is used throughout to refer to the Special Purpose Vehicle (SPV) which is party to the contract with the Authority and which is normally responsible for managing the value test. However, where another entity is responsible for value testing, such as the facilities management provider, the principles set out in this document equally apply.

Market Testing- Ensure Fair and Open Competition Ensuring openness, fair competition, and the development of clear and objective evaluation criteria are key to the success of market testing. Authorities should assess how best to encourage an active bidding market and need to avoid potential for conflicts of interests between the Project Company and bidding subcontractors. An Independent Tender Process Manager could be used.

Continued Quality of Service In order to ensure that public authorities benefit from the experience gained from value testing, the process and results should be documented in a lessons learned report and disseminated to the responsible departmental Private Finance Unit and the Operational Taskforce.

Further Advice and Support If project teams require further advice or help in relation to value testing, the Treasury has an Operational Taskforce helpdesk currently run by Partnerships UK, which is available to provide a limited amount of free assistance on 020 7273 8356 or email: operationaltaskforce@partnershipsuk.org.uk.

Benchmarking and Market Testing - Key Messages:

- start planning early;
- agree a project plan and keep to it;
- allocate dedicated personnel to manage the process for the public sector;
- make sure there is funding to resource the process;
- agree the detailed methodology up front;
- review the operating specification;
- avoid significantly changing the risk profile;
- allow time for funders' involvement; and
- keep users informed of progress.

For benchmarking:

- agree sources of benchmark information;
- the Project Company's own costs are not a benchmark;
- allow time for several iterations of benchmark data; and
- allow time for clarification and negotiation.

For market testing:

- encourage bidders to develop a competitive process;
- avoid conflicts of interest;
- ensure openness and fair competition; and
- develop clear and objective criteria.

APPLICATION AND SCOPE

SCOPE OF OPERATIONAL TASKFORCE NOTE 1

1.1 This guidance is designed to support public sector PFI contract managers in achieving value for money through the processes of benchmarking and market testing of soft services. It has been prepared by the Operational Taskforce, whose creation was announced in the policy document *PFI: Strengthening Long Term Partnerships* published by the Treasury in March 2006. The Operational Taskforce aims to provide guidance and assistance to the public sector in managing operational PFI projects, it acts on behalf of the Treasury and is currently located in Partnerships UK. Its remit however, does not extend into advising the private sector, or to mediating between public and private sector partners. In preparing this guidance, the Government has consulted with the National Audit Office, and has taken account of the findings of its own research into benchmarking and market testing.

1.2 Operational Taskforce Note 1 is intended to cover all PFI contracts where benchmarking and market testing are relevant. This will include NHS Local Improvement Finance Trusts (LIFT) and Local Education Partnerships (LEP), where benchmarking or market testing are described in the contract.

1.3 This note is generic in nature, in order to cover the broad range of PFI contracts. It divides the benchmarking and market testing processes into the following stages:

- planning the process – chapter 2;
- managing the benchmarking process – chapter 3;
- managing the market testing process – chapter 4; and
- managing the outcome – chapter 5.

APPLICATION OF OPERATIONAL TASKFORCE NOTE 1

1.4 Generally only soft services, not hard facilities management services, are suitable for value testing. The term soft service typically refers to services such as catering, cleaning and security, which do not involve significant capital expenditure or affect the value of the capital asset. Hard facilities management services such as building refits or life-cycle maintenance should not normally be value tested.

1.5 This guidance is not a substitute for contractual agreements, but should be used to help the Authority and the Project Company achieve an outcome that is satisfactory to both parties.

What is Benchmarking?

1.6 Benchmarking is the process by which the Project Company compares either its own costs or the costs of its subcontractors against the market price of equivalent services. Amendments to the unitary payment paid to the Project Company, should be agreed where differences are found between market prices, and the actual costs of providing such services by the subcontractor.

What is Market Testing?

1.7 Market testing means the re-tendering by the Project Company of the relevant soft service so that the Authority can test whether that service represents value for money. Any increase or decrease in the cost of such a service following market testing

should be reflected by an adjustment in the price charged to the Authority.

Responsibility 1.8 Both benchmarking and market testing are primarily the responsibility of the Project Company in relation to both cost and management. However, it is essential that the process be conducted in partnership. Ultimately, the choice of service provider has to be acceptable to both the Project Company and the Authority. It is therefore essential that both parties develop a clear and documented understanding of process, timetables, roles and responsibilities, aims and outputs.

Benefits of Value Testing 1.9 The value testing of soft services should assist the Authority in ensuring that continued value for money is achieved from the PFI contract. It is not a process designed to simply cut costs for the Authority, nor for the Project Company to increase prices. Value testing is designed to ensure that prices paid for soft services reflect a competitive market rate for the services provided. It also provides an opportunity for the Authority to reconsider and, if necessary, re-scope services to meet changing need. The process should also provide an opportunity for services providers to offer new approaches and technologies to the Authority thereby maximising efficiency in service provision and user satisfaction. Successful value testing could result in tangible benefits for the public sector, such as:

- improving performance and innovation;
- improving quality and productivity;
- maintaining and improving efficiency of service delivery;
- improving performance measurement;
- refining best practice; and
- providing a better understanding of external market forces in relation to the provision of services by contractors.

1.10 Value testing provisions are included in PFI contracts because requiring a Project Company or its subcontractors, to take the risk of cost increases associated with long-term contracts, such as changes in the law, is likely to be poor value for money.

Which to Chose – Benchmarking or Market Testing? 1.11 Market testing allows a more flexible approach to the provision of services than benchmarking because it ensures that the soft service provision for the project can be re-assessed to match public sector requirements at the time the exercise takes place. Market testing also offers greater opportunity for transparency and competition. Consequentially, and because of a greater maturity in the soft services market, it is now the Treasury's view that for simple soft services market testing, rather than benchmarking, is generally most likely to yield the best value for money. However benchmarking, with a fall back to market testing if parties fail to agree on the outcome, in some cases remains an acceptable alternative². Guidance from departmental Private Finance Units should be sought where benchmarking is proposed instead of market testing for new transactions.

1.12 Some contracts are precise in their requirements and specify whether benchmarking or market testing should be undertaken. Where this is the case the contract should be adhered to.

² For example, this may be acceptable for more complicated services which involve significant capital expenditure (e.g. on equipment) or which are more integrally involved with the design or maintenance or delivery solution of the project assets.

1.13 Where a contract specifies that services should be benchmarked in the first instance, but the Authority and the Project Company cannot agree a relevant price adjustment following the benchmarking exercise, the contract will normally state that market testing should be undertaken in order to establish market prices for the services concerned.

1.14 Where contracts do not specify either benchmarking or market testing, Authorities may wish to consider whether it would be appropriate, in order to ensure long term value for money, to introduce such provisions. Attempts to introduce benchmarking or market testing into the contract would need to be managed carefully, and may involve lengthy negotiations. Variations of this nature should only be considered where there is a strong value for money argument to do so.

What Should be Value Tested? **1.15** Early PFI contracts in particular are not always clear on the scope of services and costs to be value tested. In such cases, agreement between the Project Company and the Authority will be required on what is to be included within the value testing exercise. This agreement needs to be confirmed before the process commences. Soft services may be tested at the facilities management level and possibly also at the individual subcontract level, although running more than one test may involve more time and cost and could make new services more difficult to integrate. Normally the objective is to retain the existing risk profile, but the parties could agree a change to reflect changing service requirements.

When to Value Test **1.16** Where a requirement to value test is included in a contract, it is usually applicable every 5-7 years. There are a few exceptions to this general rule, such as in certain prison contracts where the complete operating subcontract is subject to benchmarking at less frequent intervals (10-14 years). In other contracts there is a longer period prior to the value test, before more typical intervals apply for the remaining duration of the contract.

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PLANNING THE PROCESS

Box 2.1 Project Planning

From initial discussions to final agreement, benchmarking may take a minimum of nine months. If it is followed by market testing, or if market testing alone is conducted, the process could take up to two years. Authorities need to employ project management disciplines from the outset and produce a project plan to cover the following considerations:

- the reassessment of requirements, and possible changes to the specification;
- the schedule - agree milestones;
- defining respective roles - agreeing responsibility;
- methodology - agree the approach to be employed; and
- communications - make sure everyone is informed.

2.1 Value testing provisions in contracts varies and it may not have clearly defined timescales. Whatever the contractual requirements, the Authority will need to start planning well in advance of the date by which any new service provision should commence.

2.2 The Authority may need assistance in finding suitable sources of data, providers of support or suppliers of services. Advice should be sought from departmental Private Finance Units or the Operational Taskforce.

FIRST STEPS

Early Planning Meeting

2.3 It is essential that, prior to commencing the value test, a plan is agreed by both the Project Company and the Authority and signed off at an appropriate level. An early meeting should be arranged between the Project Company and the Authority to agree:

- the timetable;
- the process; and
- the roles and responsibilities of all parties involved.

2.4 The Authority must have a clear understanding of the Project Company structure, where responsibility will lie for undertaking the value testing, and which subcontracts will be tested. Conflicts of interest must be avoided. It is recommended that the following documentation should be established before the value testing process begins:

- a Memorandum of Understanding between the Authority and the Project Company, setting out how the process will be conducted, and respective roles and responsibilities;
- a project plan with agreed deadlines and milestones;
- a communications plan, including staff consultation arrangements;

- for benchmarking - an agreed pro forma document to be used to compare benchmark data; and
- for market testing - a pre-qualification questionnaire, an invitation to tender, including output specifications and payment regimes, and evaluation criteria.

ROLES AND RESPONSIBILITIES

Assess Resources **2.5** The Project Company will usually conduct the front line benchmarking or market testing exercise, and so it must allocate the right level of resource to the management of the process. Value testing can also be resource-intensive for the Authority and, as it usually occurs every five to seven years, the public sector partner is unlikely to be fully resourced to manage the exercise. The Authority will need to assess the resource and skill levels available to it from its existing contract management team and determine any additional requirements. Normally, the responsibility for managing the process on the public sector side rests with its contract management team. Responsibility for schools' projects will often be at Local Authority level, and for hospital projects will often be at Trust level. Their interface during value testing will normally be with the Project Company, although it may in some contracts be with the facilities management company.

Box 2.2 Skills Required in the Value Testing Process:

- project management;
- ability to evaluate benchmark data;
- ability to evaluate financial data;
- negotiation;
- knowledge of facilities management; and
- audit.

Additional Support **2.6** The Authority should consult the departmental Private Finance Units, 4ps and the Operational Taskforce to establish what support, advice and assistance can be provided from outside the contract management team. Unless there is access to in-house technical, financial and legal resources, the Authority will need to consider appointing external specialists.

Financial Resources **2.7** To date, relatively few value testing exercises have been conducted, so a clear picture of costs has not yet emerged. In most cases costs should be a very small proportion of total contract management costs over the five to seven year period covered. Depending on the complexity of the project, and the available in-house capability, resource costs for the process, including advisers' fees, could be less than £10,000. However, if the process is particularly complicated, or if a failure to agree leads to dispute resolution procedures, in exceptional cases it could reach £100,000 or more.

An Inclusive Process **2.8** Those affected by any service changes should be involved in the value testing process from the outset to ensure that there are no unwarranted surprises, such as affordability issues, scoping difficulties, or unintended service consequences in

relation to other dependent subcontracts. The Authority will need to decide how the interests of users and other stakeholders are met. It is helpful if a user representative is included on the Authority’s project team managing the process.

Funders’ Agreement **2.9** The Authority should be aware that proposals to change service requirements, particularly where they involve a different bundle of services, might need to be implemented as a service variation using the contract’s change procedures. They are therefore likely to need the agreement of the Project Company and of the project’s funders, and at least six weeks needs to be built into the project plan for this process to be completed.

Partnership and Communication **2.10** Although value testing is the responsibility of the Project Company, the exercise should be seen as a working partnership. Information should be shared and regular communication maintained throughout. Regular meetings and progress reports will help to ensure that any difficulties that may arise can be dealt with in a timely fashion, rather than waiting until the end of the process. All stakeholders should be kept informed of progress and outcomes. It is the responsibility of the Project Company to show that the benchmark price of the services represents value for money to the Authority.

REVIEWING SPECIFICATIONS

Opportunity for Review **2.11** Value testing presents a good opportunity for the Authority to review the specifications of soft services. The Authority can, of course, seek to change requirements at any time, but linking changes to a market test gives the Authority the chance to re-scope requirements in a competitive environment.

2.12 Reviewing specifications may result in adjustments to service levels that more closely meet the Authority’s objectives and the needs of users. Such a re-balancing of the contract will help the Authority obtain optimum value from the exercise. As part of this review, the Authority may decide to bring services back in-house, but will need to be aware that this will involve a full risk assessment, a renegotiation of the contract and potential costs associated with such actions.

Box 2.3 Two Examples of Identifying Changing Needs

1. In a hospital project, the Authority decided that the frequency of some office cleaning activities and the twenty four hour provision of porters were no longer necessary, and obtained cost savings by reducing the requirements. These savings were used to partially fund increased levels of laundry provision, because of an increase in the number of beds.

2. In an office accommodation project, it became apparent after the contract had become operational that, at peak times, the reception area and security system were unable to cope efficiently with the flow of visitors. In revising the output specification for these services, the Authority was able to encourage innovative approaches to solving this problem.

Formalise Previous Changes **2.13** It may also be the case that, during the operational phase of the contract, the service provided has been varied informally. These changes can be captured formally within the revised specifications.

Joint Review **2.14** The review process should be a joint exercise. The Project Company should be encouraged to feed its own ideas for improving the services into the process and also feed in any cost reduction proposals. The output should be a set of specifications agreed with the Project Company.

Timing required **2.15** For a full reassessment of soft services requirements, the Authority should allow sufficient time at an early stage in the project plan to review the specification thoroughly and to agree any changes with the Project Company before the value testing exercise begins. This is likely to add two to three months to the process. It is always possible to make changes to PFI contracts without a value testing exercise; however this process offers an opportunity for a full appraisal of service needs and an assessment of value for money.

SETTING A TIMETABLE

Detailed Timing **2.16** The Authority should agree a detailed timetable with the Project Company at an early stage, whether the contract dictates this or not. It is essential that this work be properly timetabled, both to ensure that contractual provisions are complied with and to avoid any rushed work. Any timetable included in the contract should be reviewed to determine whether it is practical.

2.17 The timetable should include deadlines by which the Project Company is to provide benchmark data and for responses by the Authority. Additional time may be needed if the contract specifies market testing as a fall back to benchmarking. Sufficient time should be allowed for a number of iterations of the data, for negotiation, and for meetings of decision-making bodies. The timetable should also have sufficient flexibility to ensure that, if necessary, deadlines can be renegotiated by agreement. In the event of a market test, the timetable needs to include sufficient time for prospective bidders to visit the project site, review the documentation and seek clarity or additional information. The Authority and bid evaluators may also wish to visit sites where prospective bidders are providing similar services. The Authority should consult other authorities that have undertaken market testing, or its Private Finance Unit, to establish the feasibility of the timetable in the light of their experience.

Interim Solutions **2.18** Authorities should not seek to extend an existing contract if the procurement falls behind timetable. Contract extensions are poor procurement practice and risk being poor value for money. The parties should, instead, start early, keep to the timetable, and ensure that sufficient time is allowed for each stage of the process. The parties may, if necessary, agree an interim solution to service provision should it prove impossible for any reason to meet the agreed timetable. Such a solution may mean that the current service provider agrees to continue to provide services at an agreed price for a determined period of time

Box 2.4 An Indicative Benchmarking Timetable in an Accommodation Project

Activity	Weeks until benchmark date
Internal planning meeting to agree resource	40
First meeting with Project Company to discuss timetable	38
Further meetings with Project Company as required	38 – 22
Review specifications and agree changes	38 – 26
Competition for advisors	38 – 26
Appoint and brief advisors	30 – 22
Project Company submit first proposals	30 - 14
Meeting to clarify and negotiate	28 – 4
Agree new costs	12 – 1
Amend contracts and introduce new prices	0

Box 2.5 An Indicative Market Testing Timetable in a Hospital Project

Phase	Activity	Months until market test date
Preparatory	Update service specification to reflect current levels Include service variations and material specification 'creeps' Review movements in service economics and expectations of outcome with client Identify service activity, staff transfer and specification information for provision by incumbent service provider	24 - 12
Confirm key requirements	Change to service specification Service groupings to be required Core and variant bids Client Human Resources for retention of employment staff Short listing and selection process Evaluation process Procedure should too few bidders compete Timetable for market making process Mechanism for adjustment of unitary payment Confirm PFI collateral agreements that new provider will need to accept in addition to service contract	24 - 12
Pre-qualification	Advertise pre-qualification Send out pre qualification questionnaire Pre-qualification questionnaires submission date Evaluate and announce shortlist	18 - 9
Finalise tender specification	Client sign – off to finalised tender specification and build tender document pack	18 - 9
Tender	Send invitation to tender to short listed bidders Tender submission deadline Tender evaluation Announcement of preferred provider	12 - 6
Mobilisation	Financial Close Commence staff transfer minimum of 90 days before commencement Service handover / commencement Contract market test date Adjust unitary payment to reflect new service	9 – 0 9 – 0 9 – 0 0 +1

THE PROTECTION OF EMPLOYMENT

Workforce Issues **2.19** If value testing leads to a change in a service provider, then it is imperative that early consultation takes place. Employee issues should be borne in mind from the start, as Transfer of Undertakings (Protection of Employment) Act (TUPE) issues may arise. Even if they do not, all parties should ensure that staff are treated in accordance with Government policy and good practice. To ensure that the value for money delivered by PFI does not come at the expense of employees' terms and conditions, consultation processes should be observed and recorded, referring to current guidance as needed, for instance, on bulk transfers. The Project Company should ensure that the incumbent service provider supplies full and accurate information about employees when required, and that key members of staff are not redeployed, or major changes made to terms and conditions, in advance of value testing. The application of the Code of Practice³ on Workforce Matters should be followed where appropriate, as should the Treasury guidance: Fair Deal for Staff and Fair Deal for Staff Pensions⁴.

CREATING AN ENVIRONMENT FOR EFFECTIVE COMPETITION

2.20 The Operational Taskforce is considering how best to help develop a competitive market in value testing by:

- setting up and administering a database of benchmark data and costs;
- online listing, where known, of the likely dates of value testing exercises in PFI contracts; and
- providing links to other sources of value testing data.

2.21 This work is still in the early stages of formation. Its success will depend on feedback and information from individual contract managers. Reliable feedback and communication from individual projects will allow the public and private sectors to make nationwide comparisons and ensure value for money for the taxpayer. For more details of the Operational Taskforce database, see www.partnershipsuk.org.uk.

³ Code of Practice on Workforce Matters in Public Sector Service Contracts, available from http://archive.cabinetoffice.gov.uk/ops/workforce_reform/code_of_practice/imndex.asp

⁴ Code of Practice on Workforce Matters in Public Sector Service Contracts, available from http://archive.cabinetoffice.gov.uk/ops/workforce_reform/code_of_practice/imndex.asp

3

MANAGING THE BENCHMARKING PROCESS

Box 3.1 The Benchmarking Process - Key Points:

- agree the process – both parties to agree both process and methodology;
- communications – develop and maintain a dialogue;
- information – what is needed; where to get it;
- validation – how to check the Project Company's claims; and
- clarification and negotiation – an iterative process.

INVOLVEMENT AND RESPONSIBILITY

3.1 This section of the guidance examines how best to get value for money from a benchmarking exercise. It is important that both the Authority and the Project Company are jointly and closely involved throughout the process. However, it is the Project Company's responsibility to manage the process. The Project Company, in consultation with the Authority, should ensure that the following issues are properly addressed:

- that the cost comparison only reflects the services being benchmarked;
- that the cost comparison includes factors relating to risk inherent in a change of service provider, such as mobilisation costs, which should be verified by the Authority;
- whether individual services are to be benchmarked separately, or all together; and
- the reliability of benchmarking data and the ability to verify its appropriateness as a comparator for the service provided.

Agree the Methodology

3.2 The contract should describe what services are to be benchmarked and what they are to be benchmarked against, although this may not be the case in some earlier PFI contracts. It is important that agreement on methodology is reached at an early stage. Benchmarking should be carried out on an open book basis; the data and the data source should be open to review and challenge. The Authority needs to have full access to all raw data and understand the methods by which cited figures were reached. This is so all parties can have confidence in the process. The box below summarises the methodology to be employed in a benchmarking exercise.

Box 3.2 Benchmarking Methodology:

- the exercise is to be undertaken by both parties;
- agree the scope;
- where possible, use an objective comparison to previously agreed reference sites, i.e. general hospitals of a similar size;
- the exercise will compare the prices, standards and specifics of similar services;
- the benchmark providers and the current provider must be similar in terms of skill and reputation;
- benchmarking is on an open basis – all numbers are transparent and there are no locked spreadsheets;
- the Authority and Project Company to exchange information on benchmark prices;
- if the Authority is satisfied – notify the Project Company and amend contract prices, if relevant;
- if the Authority is not satisfied – move to market testing.

BENCHMARKING DATA

Agree Comparators **3.3** A key factor in benchmarking is agreeing the right comparators. Contracts may include details of what comparators should be used. If they do not, parties will need to find appropriate comparators. This should include both PFI and non-PFI contracts, adjusted where necessary to take into account different risk profiles. Comparators, where possible, should provide clear incontrovertible costs, so that valid conclusions can be made. It is not appropriate for comparators to only include the existing providers benchmarking data.

Information Gathering **3.4** Both the Project Company and the Authority will need to collect comparative information, and a number of sources for this are suggested below. The Project Company will require this information for the purposes of identifying a benchmark cost for the services and the Authority will need it to examine, interrogate and validate the results of the benchmark.

Sources of Data **3.5** Agreeing on sources of data is one of the most important challenges in a benchmarking exercise. Crucially, the process should not be carried out using data supplied by the Project Company from its current supply of services, as it is extremely difficult to reasonably assess the objectivity of such data and the efficiency of the supplier. Equally, the exercise should not be carried out using untested data supplied by the Project Company. The Authority has a right and a responsibility to interrogate its data source, and to provide other comparators. Ultimately, though both parties need to agree the sources of data.

3.6 The Authority can draw on a number of sources to provide information to validate the benchmark data provided by the Project Company, but in doing so should appraise the extent to which the source and quality of the data makes it comparable. Data sources may include other contracts the Authority has for PFI, other contracted-out services and contracts managed by other public authorities. Further, departmental Private Finance Units, the Department of Health's Estates Returns Information

Collection (ERIC), the Operational Taskforce, 4ps and technical and financial advisers may also have access to a relevant range of information. The Authority may also wish to refer to the Public Service Benchmarking Service (www.benchmarking.gov.uk). There are also a number of specialist organisations that offer benchmarking information services.

Negotiation and Validation **3.7** Both parties should agree the description and category of costs being benchmarked so that they are confident that they are comparing like with like. Where adjustment is required to facilitate a fair comparison between data, the parties must be explicit regarding the assumptions used to make such adjustments. The Authority and the Project Company must maintain suitably detailed records for audit purposes.

3.8 Validating benchmark data is a complex and specialised task and most Authorities are unlikely to have the necessary expertise, therefore specialist advice may be necessary.

3.9 It is unlikely that benchmarks will be agreed without an element of clarification and negotiation. Public sector managers have a responsibility to interrogate the data that they are presented with, and need to understand how conclusions were reached.

Overheads **3.10** The cost of services may also include the overheads associated with soft facilities management. Where an integrated hard service and soft service model is in operation, the parties should disaggregate the overheads for hard services, for example by splitting out helpdesk costs for hard services.

3.11 In light of this, the Authority needs to be particularly careful about how overheads are treated by the Project Company and that the right level of overhead is applied to the right cost. This may involve a detailed analysis of the financial model, possibly with the help of modelling specialists. Data and sources must be transparent, and the Authority must understand the detail. Where a Project Company is reluctant to provide information or unable to supply appropriate data, the Authority may wish to consider imposing market testing.

DISPUTE RESOLUTION

Failure to Agree **3.12** A contract may or may not describe the procedures to be followed in the event of a failure to agree. The Authority and the Project Company may fail to agree on the detail of how the process is to be managed (in relation to timescales, reporting formats, or comparators) or on any resulting price adjustment.

3.13 Both parties need to be clear before the process starts, what the dispute resolution procedures are to deal with any failures to agree, and agree how they will be applied. The Authority should also consider whether there are alternative procedures that might be more appropriate and, if necessary, seek to agree such alternative arrangements with the Project Company. This may require the intervention of mediators. The ultimate fall back from a benchmarking exercise is to market test.

3.14 Some contracts prescribe that where there has been a failure to agree either the process or the outcome of benchmarking, the parties automatically move to market testing. Assuming there is a transparent and fair process, a fair market price for the services will then be established through competition. Where such a provision does not exist in the contract, the steps that might typically follow a failure to agree the benchmarks could be:

- mediation;
- escalate dispute to more senior levels;
- a formal dispute resolution procedure; or
- if agreement still cannot be reached, market testing.

Box 3.3 Benchmarking Summary:

- plan early;
- involve relevant personnel early in the process;
- allocate appropriate funding;
- review the operating specifications;
- agree benchmark sources;
- Project Company's costs are not a benchmark;
- agree treatment of overheads;
- allow time for several iterations of data; and
- allow time for clarification and negotiation.

4

MANAGING THE MARKET TESTING PROCESS

Box 4.1 The Market Testing Process – Key Points:

- planning – timetable and resources;
- transparency – fair competition is essential;
- conflicts of interest – how to be avoided;
- specifications – review and agree;
- competition process – PQQ to award; and
- transfer of contract – process and communication.

INVOLVEMENT AND RESPONSIBILITY

Responsibility 4.1 Market testing is the responsibility of the Project Company. A project team, including representatives of the Project Company and the Authority, should be set up to oversee the market testing process. The Authority should consider including representatives of users and other stakeholders in the project team. This team should meet regularly and its decisions should be recorded by the Project Company.

Conflict of Interests 4.2 Strict procedures should be put in place to ensure that none of the parties with a potential conflict of interest have involvement in awarding the tender. If any company associated with the Project Company, its shareholders, or its principal operating sub contractor (if this entity manages the market test) intends to bid for the tendered services, an Independent Tender Process Manager (ITPM) should be appointed.

Box 4.2 The Role of an Independent Tender Process Manger

The role of the ITPM would be to oversee the process and to assure the Authority of the probity of the competition. If the contract does not provide for such an appointment, the Project Company and the Authority could still agree to appoint someone to this role, and may wish to do so if there is a possible conflict of interest. It is suggested that the cost of such an appointment is shared between the Project Company and the Authority, so as to ensure impartiality. Further information on how to appoint an ITPM may be obtained from the Operational Taskforce.

4.3 An alternative approach might be for the Authority to take a more supportive role in managing the market test. Unless appropriate procedures are agreed then it may be necessary to exclude conflicted bidders to demonstrate fairness.

ACHIEVING VALUE FOR MONEY IN THE MARKET

4.4 Prospective bidders may be reluctant to compete against an incumbent service provider. The Authority must satisfy itself that there is effective competition and be proactive in encouraging prospective bidders. It should actively support the Project Company in making a market by ensuring that the competition is advertised widely in appropriate media such as trade journals and, where necessary, assuring prospective

bidders that the competition will be fair and transparent. Prospective bidders may be more likely to consider a competition fair when an ITPM is engaged.

Anticipating Outcomes 4.5 The Project Company and the Authority should agree at the start of the process how to handle particular outcomes, such as where there is no bidder, or a single bidder. The agreement should therefore include work to identify possible causes of an undesirable outcome, such as incorrect specifications or unrealistic price expectations, as well as action to handle any delay.

TENDERING SERVICES

EU Directives 4.6 Although Project Companies are private sector organisations and are therefore not required to follow the procedures set out in the EU Procurement Services Directive, the principles of fair and open competition and transparency should still apply. Project Companies should be required to present proposals to the Authority on how they intend to ensure that fair and effective competition is maintained within the market testing exercises. Authorities should ensure that Project Companies comply with the general principles of transparency and equal treatment. Box 4.3 is a summary of these principles.

Box 4.3 - Principles of EU Procurement Directives

- The procurement must be advertised in an accessible form, e.g. the internet, journals, newspapers and the Official Journal of the European Union (OJEU).
- It is essential that there is equal access for economic operators from all EU Member States.
- Conditions imposed on tenderers must not lead to direct or indirect discrimination.
- The number of organisations invited to tender may be limited, provided that the choice of suitable tenderers is transparent and non-discriminatory and is sufficient to ensure an adequate level of competition.
- The award decision must be adopted in accordance with the evaluation criteria laid down at the start of the process and with the principles of non-discrimination and equal treatment.

Advice 4.7 If Authorities have concerns about how to ensure fair competition or about possible conflicts of interest involving Project Companies managing market tests, advice should be sought from the Operational Taskforce helpdesk.

Tender Packages 4.8 The parties will need to agree which services are tendered and whether they are to be tendered separately, as a bundle or both. There may, for example, be advantages in tendering external services, such as grounds maintenance, separately from internal ones. Alternatively, services such as security and reception desk activities may be inextricably linked and may need to be tendered together. It will be for tenderers to decide whether to submit tenders for some or all of the market tested services. However, if a tenderer submits a tender for a group of services, then it may be required to provide all or any of those services in that group.

4.9 The exact grouping of services can be a source of conflict. The Authority may want to make efforts to ensure that bidders are not discouraged from bidding for less attractive services. The Project Company may seek to minimise the number of service

interactions by inviting tenders for large groups of services. Ultimately the contract will be awarded to the bidder or bidders that deal best with all of the Authority's service needs.

- Advertising** **4.10** Invitations for Expressions of Interest should be advertised in relevant trade journals and other media to ensure that a range of prospective bidders are given a fair opportunity to respond. These can be supplemented by invitations to known prospective bidders to ensure that they are aware of the opportunity.
- Pre-
Qualification** **4.11** Interested bidders should be required to complete a pre-qualification questionnaire (PQQ) that aims to confirm in outline the financial, technical and operational capability of the organisation to contract for the services. The PQQ should be developed jointly between the Authority and the Project Company. The invitation to submit a PQQ should be accompanied by an outline of the services to be tendered and key requirements of the tendering process. The Project Company should ensure that the financial covenant of prospective bidders is equivalent to that required when the contract was first awarded.
- 4.12** The Authority has a right to challenge the inclusion or exclusion of any company, and is encouraged to suggest companies for inclusion, where it has evidence of good performance. This challenge should apply equally to pre-qualification lists and the evaluation of responses.
- Evaluating
Responses** **4.13** The project timetable should allow adequate time for the evaluation of PQQ responses. This should be undertaken jointly by the Authority and the Project Company in accordance with pre-agreed criteria. A shortlist of organisations to receive Invitations to Tender (ITT) should then be agreed.
- Exclusions** **4.14** The Project Company may exclude a company from bidding where, in its reasonable opinion, it believes that such a company would increase the risk borne by the Project Company. The Authority should be able to request the exclusion of any prospective bidder on the grounds of capacity, capability, financial standing and security or for reasons that, in the opinion of the Authority, are in the local interest. Organisations that are not short-listed should be given the opportunity of a debrief.
- Failure to
Agree on
Bidders** **4.15** If the parties fail to agree on the number and identity of the prospective bidders within a pre-determined period, usually specified in the contract but, if not, at least six months before the due date, the matter will need to be referred under the contract's dispute resolution procedures.
- Invitation to
Tender** **4.16** ITTs agreed with the Authority should be issued to all short listed bidders. The timetable put in place should allow prospective bidders to visit the site, review the documentation and seek clarity or additional information on areas of uncertainty.

Box 4.4 Contents of Invitation to Tender

The ITT should, as a minimum, define:

- the services being tendered;
- the contractual arrangements to be applied to the new contract;
- the payment mechanism;
- requirements for the management of staff transfers;
- the commercial opportunities available;
- the detailed risk register; and
- the obligations on the service provider.

No Collusion 4.17 Tenders should include a certificate confirming no collusion between any bidding organisations, or with the Project Company. Where further similar declarations are required under the contract, these should also be completed and recorded.

EVALUATING RESPONSES

Evaluation Criteria 4.18 Bid evaluation should be performed in accordance with the requirements of the contract, where included. Where the evaluation requirements are unclear or absent, the Authority and the Project Company should draft and agree their requirements at an early stage. Evaluation criteria, including weightings, must be objective and settled before bids are opened and will normally cover the price and quality of the proposal. An evaluation team, led by the Project Company and including representatives of the Authority and its advisers, will need to be established before bids are received.

Box 4.5 Evaluation Criteria

Evaluation Criteria must be objective and will typically include issues such as:

- price;
- technical capacity – the ability to do the work;
- quality control procedures – how consistently high levels of quality are achieved;
- management structures and capability – to ensure consistent delivery and swift rectification of any delivery failures;
- experience of the particular sector (e.g. hospitals, schools); and
- accreditation – e.g. ISO 9000.

Authorities will need to agree with the Project Company the appropriate weightings for each of the criteria.

Audit 4.19 All evaluation markings and decisions should be recorded and kept secure and available for audit by the Authority.

Security, Guarantees and Approvals 4.20 The Project Company will be responsible for drafting any changes to the subcontracts and for obtaining any required documents such as parent company guarantees or other security including, where necessary, collateral deeds, approvals from rating agencies, funders' technical advisers and insurers.

Debrief 4.21 Unsuccessful bidders should be offered a debrief on their bid.

Managed Transfers 4.22 It is important that transfers between service providers do not disrupt the services received by users. The handover between service providers must be managed carefully to ensure the successful transfer of any staff and records and to ensure that there is, as far as possible, a smooth transition to the new provider.

Consultation 4.23 Consultation processes should be observed and recorded. The communications strategy drawn up as part of the initial project plan should allow for regular and open consultation with staff being transferred, and with users of the service. Users need to be made fully aware of any changes to services, whether or not the provider is being changed.

Accrued Penalties 4.24 The issue of accrued service provider contract penalty points at the start of a new subcontract should be handled in accordance with the contract. As a general principle, the possibility of resetting penalty points to nil should apply only at subcontract level, and not to the incumbent contractor if it wins the contract. There should also be no resetting at Project Company level, because it should be held to account for the performance of its subcontractors. Authorities may however consider the extent to which blame can be apportioned to the Project Company when deciding whether to reset penalty points. Penalty points should only be used to incentivise good behaviours in contractors.

Box 4.6 Market Testing Summary:

- plan early;
- involve relevant personnel early in the process;
- allocate appropriate funding;
- review operating specifications;
- avoid significantly changing the risk profile;
- allow time for funders' participation;
- develop the market;
- avoid conflicts of interest;
- ensure openness, probity and transparency;
- keep users informed of progress; and
- consult with staff and unions.

5

MANAGING THE OUTCOME

IMPLEMENTING CHANGES

5.1 After agreeing the outcome of the value testing process, the changes agreed need to be implemented. There may be up to three major changes:

- changes to the unitary payment;
- changes to the service specifications;
- change of service provider.

Unitary Payments

5.2 The Authority will need to be assured that any change to the unitary payment is properly calculated. The contract will normally include a cost adjustment mechanism for translating changes in costs into changes to the unitary payment. The outcome of the review will not necessarily be a direct pass through to the public sector of the benefit or burden of the cost change. Normally, the revised cost will apply at subcontractor level, and it is important that the Authority is clear how this translates through into a revised unitary payment against the PFI contract. The Authority may need the assistance of financial advisors to check that this is done correctly, and that any allowed overhead costs are transparent and are applied appropriately.

Changes to Specifications

5.3 Where the Authority and the Project Company have agreed amendments to the service specifications, either the contract or the timetable will determine when the changes are made. Some soft services such as car parking and catering, may include an element of third party income and in some cases such income may have been underwritten as part of the base case financial model, or may be guaranteed to the relevant subcontractor by the Project Company. In such cases, Authorities will need to be assured that value testing does not result in any unintended transfer of demand or pricing risk back to the Authority.

Change of Service Provider

5.4 If a market test results in a change of service provider, both the Project Company and the Authority will need to manage the process carefully to ensure that there is a seamless delivery of services. The main responsibility for managing this process lies with the Project Company, which will also be responsible for ensuring that the new service provider fits in to any relevant interface arrangements with other service providers or the construction subcontractor. However, the Authority and the Project Company will need to inform users and contract managers of the changes and agree any transition arrangements.

Timings

5.5 A change to the unitary payment can occur at a discrete time. Changes to the services will require more management and it is possible that changes will need to be phased in. Although it will be the responsibility of the Project Company to implement any changes and ensure that staff are suitably trained, the Authority will also have a role to play. It is important that contract monitoring staff and service users are aware of the changes.

Interface Arrangements

5.6 Service providers will often be party to interface arrangements with other subcontractors on the project. For instance, there may be interface arrangements in place between the construction subcontractor and other service providers, or between soft service providers themselves. The bid and transfer arrangements will need to cover any new contractor's entry into these interface arrangements. Although these interface

arrangements are not part of the services actually being tested, they are a necessary part of the process of inserting the new contractor into the project. The Authority should, at the outset of the PFI transaction or tender process, as part of its due diligence, ensure that the relevant interface agreements have Deeds of Accession in a pre-agreed format attached to them, in order to provide a simple mechanism for new or replacement parties to join the contract. Failure to have such mechanisms in place could undermine the market test.

The Outcome 5.7 The outcome of the value testing process must be communicated properly to providers and users of the service to ensure they have a clear understanding of the outcome. This is most important where the parties have agreed a change to the scope of service provision or where incumbent service providers are being replaced.

CAPTURING THE LESSONS LEARNT

Documenting the Process 5.8 After completing the value testing exercise, it is important to document the process and capture the lessons learnt so that they can be applied when the exercise is next undertaken. With a 5 to 7 year gap between exercises, it is probable that different people will be responsible for managing the next process.

5.9 The following points should be captured in a lessons learnt document:

- the benchmarking or market testing process;
- the outcome;
- what worked well;
- problems encountered; and
- recommendations to improve the process.

5.10 The production of the lessons learnt document should be a joint exercise and the parties might consider amending the value testing provisions in the contract to reflect the lessons learnt. In order to ensure that public authorities benefit from the experience gained, departmental Private Finance Units should consider how best they intend to capture and disseminate the information gathered by contracting Authorities.

5.11 There are a number of interested parties with whom the processes and results of the value testing exercise should be shared, including:

- departmental Private Finance Units;
- other Authorities preparing to go through the same process; and
- the Operational Taskforce whose role includes the gathering and dissemination of data, information and best practice on operational issues, including information on value testing.

Box 5.1 Further Help and Support

If project teams require further advice or help in relation to benchmarking or market testing, the Operational Taskforce is available to provide assistance and can be contacted by telephone on 020 7273 8356 or e-mail operationaltaskforce@partnershipsuk.org.uk

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