



# Improving DBFOs



consultation document

### The Consultations

This is the first of the three linked consultations in respect of developing new and/or improving the existing, procurement and contracting policies.

The other two, which are expected to be released in early 2003, are :

- Introducing private finance into operation & maintenance contracts such as the managing agent contracts (PFMAC).
- Widening the use of performance specifications on all contracts and evaluating different strategic options for changing the way the Highways Agency specifies its requirements.

We seek your views on the proposals within these documents and welcome any other ideas that you may have to improve the procurement process.



# Improving DBFOs

Consultation Paper

December 2002

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 foreword

The Highways Agency is responsible for the management and development of England's motorway and trunk road network. The network is valued at approximately £60 billion.

The Government's *Transport 2010: the 10 Year Plan*, published in 2000, makes it clear that the maintenance and further development of our network is a vital component of the nation's economy and social fabric. The Highways Agency Procurement Strategy - *Delivering best value solutions and services* (Highways Agency, 2001), provided the procurement framework to deliver the spending plans and the outcomes included in the *10 Year Plan*. This consultation is a further step in delivering that strategy.



One of the Highway Agency's key objectives is to deliver the Government's Targeted Programme of Improvements (TPI). The *10 Year Plan* envisages that around 25% by value of current and new major schemes will be procured using private finance, including the Design, Build, Finance and Operate (DBFO) contract under the Government's Public Private Partnership (PPP) initiative.

The Agency already has eight DBFO contracts in operation and a further two at tender stage. We aim to build on the success of these projects by updating the DBFO contract procurement process.

Our objectives for improving DBFO can be grouped under three main headings :

- Speeding up delivery
- Increasing flexibility of the contracts
- Reducing tendering costs

In responding to this consultation, you are asked to consider these and any other issues, bearing in mind our objectives. Working in partnership with industry requires mutual trust and regular communication, and this consultation exercise provides an opportunity for us to work together.

We look forward to receiving your views and ideas in response to this consultation document.



**Tim Matthews**

Chief Executive





## the consultation process

This document describes some options for change to DBFO procurement. It is aimed at the key players in our DBFO programme – DBFO companies, contractors, consultants, financiers, financial advisors, legal advisors and others.

Your responses and views are sought on the proposals in this document. You are requested to respond specifically to the questions on pages 18 and 19, but any other suggestions you may have for speeding up and improving the flexibility and the delivery of projects would be welcomed.

The Agency's intention is to summarise your replies in a published report without attribution.

Those responding may be invited to follow up their responses in a series of workshops that start after the consultation is complete.

Web site address of document is :  
[www.highways.gov.uk/roads/dbfo/dbfo\\_improve\\_dec\\_02/index.htm](http://www.highways.gov.uk/roads/dbfo/dbfo_improve_dec_02/index.htm)

Please e-mail your replies and comments by **28 February 2003** to

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## introduction

**1.1** The Agency has a major role to play in delivering the objectives of the Government's *Transport 2010 : the 10 Year Plan (DETR, 2000)*. These comprise easing congestion, providing effective maintenance, providing safer travel conditions, providing better information to the road user, providing smarter and quieter roads and delivering all these in partnership with industry.

**1.2** Some problems on the network can only be solved by increasing capacity. Government Offices, in partnership with regional planning bodies, have been carrying out multi-modal studies to identify solutions for congested transport corridors across all modes of transport. Measures recommended by these studies have already included improvements to motorways and trunk roads and the Agency will progress those accepted by the Government.

The *10 Year Plan* envisages that around 25% by value of current and new major schemes will be procured using private finance, including the Design, Build, Finance and Operate (DBFO) contract.

**1.3** The improvements arising from the multi-modal (and other) studies that are implemented as DBFO schemes are likely to be at different stages of the statutory process. Most will not be as fully developed as previous DBFO projects, and may involve on or off-line improvements.

**1.4** Two examples of the types of projects being considered for the DBFO programme are provided in **3.2**.





## improving DBFOs : highways agency objectives

The objectives that the Agency seeks to achieve by improving DBFO procurement are:

- Ensure best value is achieved throughout the life of the contract providing continuous improvement
- Speed up delivery
- Minimise transaction costs for all parties, and the time taken to carry out the selection process, consistent with holding a fair competition
- Select suppliers on the optimal combination of quality and price
- Secure the benefits of early contractor involvement
- Incentivise innovative solutions
- Improve the flexibility of the contract
- Maintain a competitive and sustainable market





## background

**3.1** The Agency intends to ‘package’ schemes from the Targeted Programme of Improvements (TPI) and schemes emerging from the multi-modal studies, into discrete contracts, with each contract likely to include a number of different schemes at different stages of development.

The responses to this consultation process will also inform the decisions to be taken on which schemes should be packaged into DBFO contracts to secure best value.

**3.2** It is expected that there will be a small number of large value DBFO contracts to be procured over the next few years. Examples of such projects are:

### Project 1 example

Capital value: £700 million

Upgrade of 70 km of 30 – 40 year old motorway from dual 3 to dual 4 lane. Widening to be carried out within available landtake except perhaps for some junctions and structures. Operation and maintenance of project road for 30 years.

### Project 2 example

Capital value: £250 million

Total route length 100 km with road improvements required for approximately 50 km made up of upgraded sections of road from single to dual carriageway, bundling of capital improvement schemes providing by-passes (each length being 2 km to 10 km) etc.

Many junction improvements including conversion to grade separation where necessary. Operation and maintenance of project road for 30 years.





## some ideas on improvement

**4.1** The Agency intends to speed up the delivery of future DBFO projects, reduce transaction costs for all parties during the tender period and improve the flexibility of the DBFO contract itself.

**4.2** Currently, the DBFO process typically comprises the following key stages :

- Data collection and preparation of prequalification and tender documentation
- OJEC notice
- Prequalification
- Prequalification response evaluation
- Tender
- Tender evaluation/negotiation
- Short listing
- Negotiations
- Best and Final Offer (BaFO)
- Selection of Preferred Bidder
- Final negotiations and financial close

These stages are illustrated in figures 1 and 2 on the pages 14 and 15.

**4.3** From the examples given in **3.2**, it can be seen that the projects taken forward on the DBFO basis could require different processes. The scope for improvement extends from simply enhancing the tender process to using the concepts of early contractor

involvement to speed up the overall delivery process. These factors are further discussed below.

### Improving the tender process

**4.4** Some ideas for improving the tender stage include :

- Reduce the scope of the technical submission at tender stage leaving full design, departures processing etc to follow at short-listing stage.
- Reduce the scope of the financing and commercial submission at tender stage.
- As an alternative to the changes mentioned in the two bullets above, the scope of the tender stage submission could be increased so that the short-listing stage can be dispensed with.
- Provide better data to tenderers (e.g. improved asset data quality, quantity and format, comprehensive site investigations, carry out in advance statutory undertaker works).
- Identify a “freeze-point” during the tender process beyond which no change is allowed.

## Starting Earlier

**4.5** Recently, for conventionally funded projects, the Agency has adopted the Early Design & Build (EDB) procurement route. This is expected to deliver better value projects more speedily. The Agency is keen to apply the principles of EDB to DBFO.

(See the Glossary at the back of this document for brief details of EDB).

**4.6** There is potential for a range of approaches to be developed that embrace this concept.

Two possible generic forms are described below.

### **Option 1 - Apply the principles of EDB and then convert to DBFO**

Appoint a supplier (contractor and designer) on a similar basis to EDB. The supplier develops the design while progressing the scheme through the statutory authorisation process.

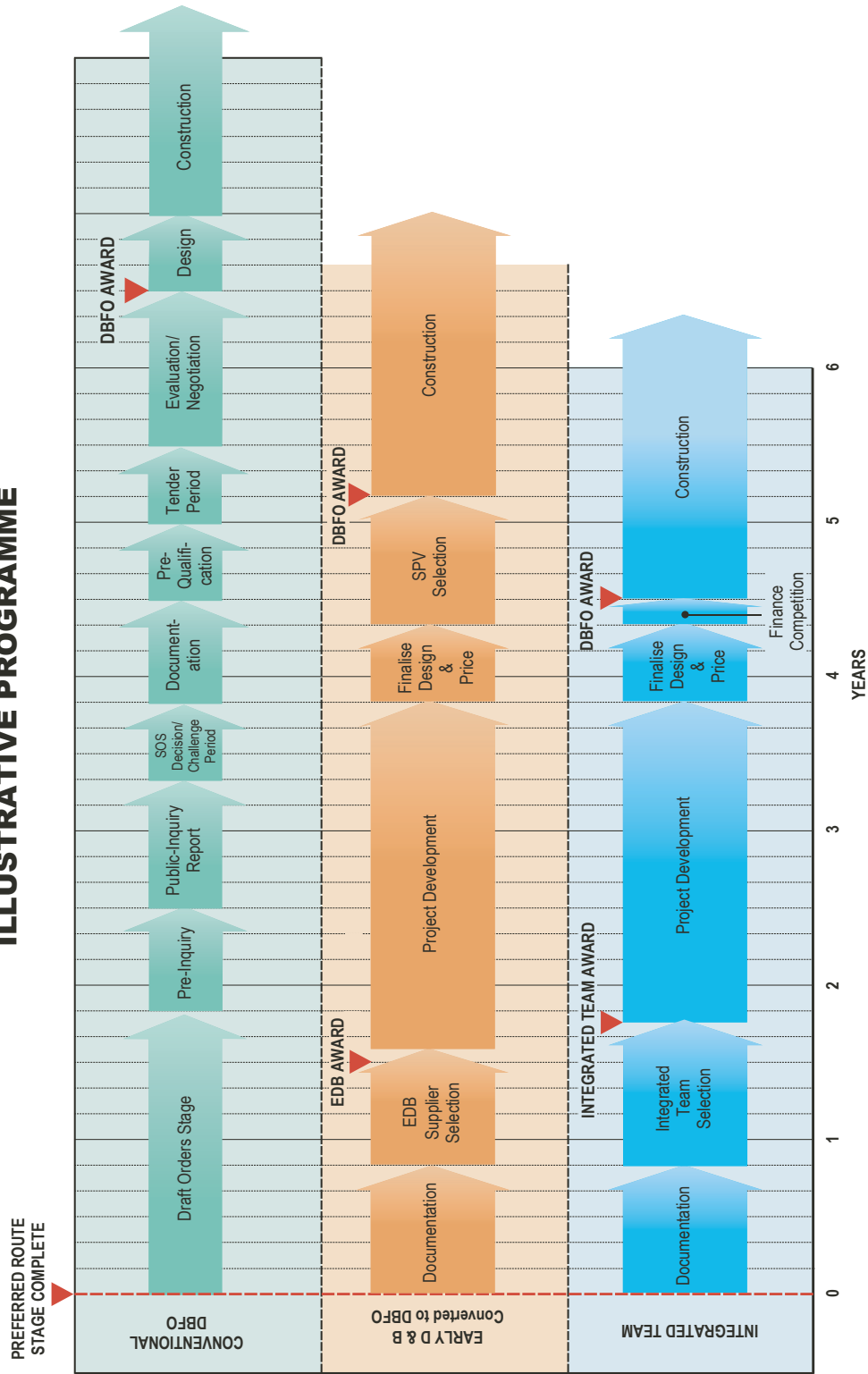
At the end of the development stage, the supplier agrees a price for constructing the works with the Highways Agency. The Highways Agency then invites Special Purpose Vehicles (SPVs) to bid for a DBFO contract. Under this DBFO contract, the construction works would be carried out by the (EDB) supplier as nominated subcontractor.

### **Option 2- Apply the principles of integrated team working and then convert to DBFO**

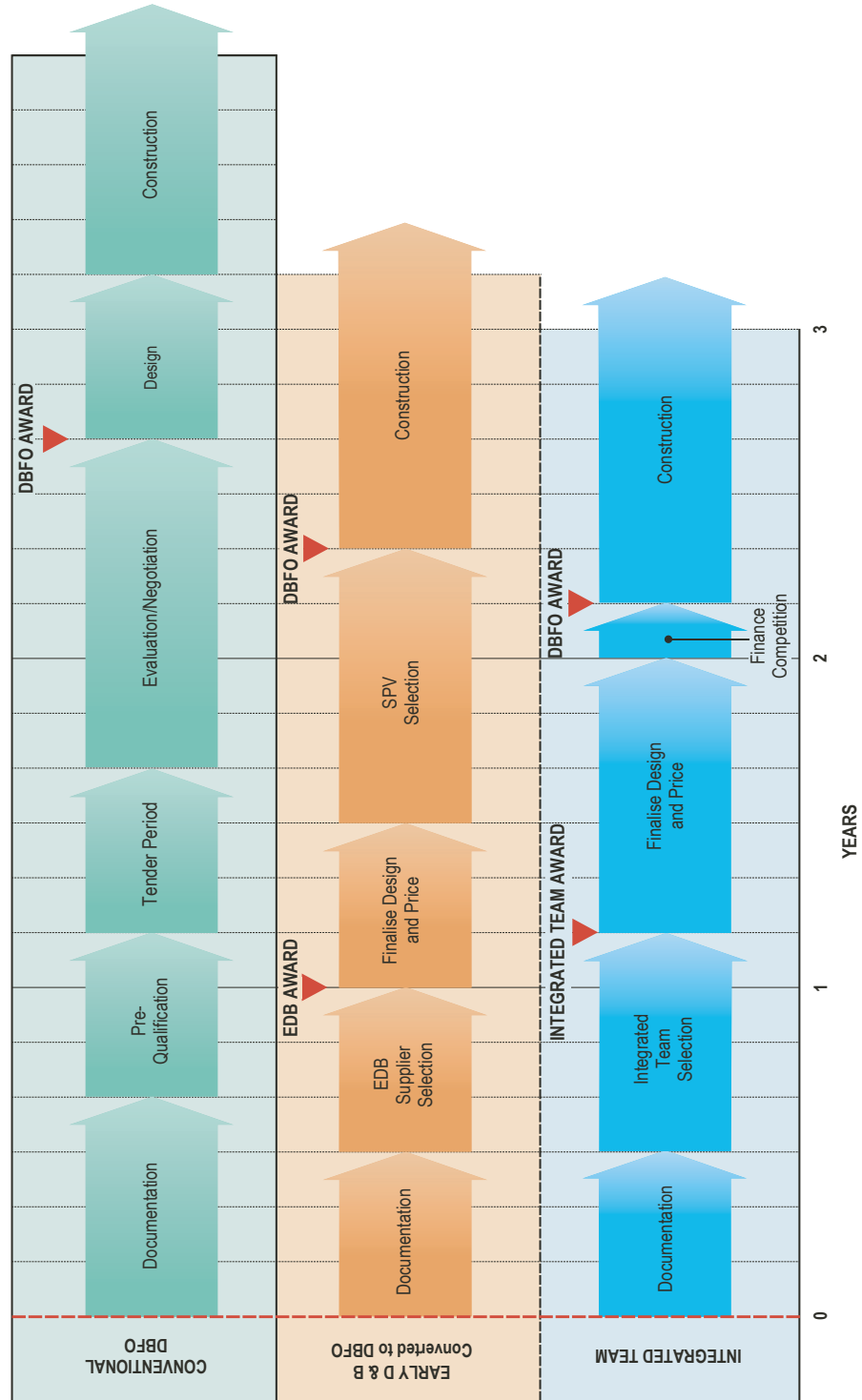
From the outset, the Highways Agency appoints an SPV (based upon a quality/price selection process) to work with it to carry forward all aspects of the project. The integrated team would steer the scheme through the statutory processes, complete the design, and develop a price for construction, maintenance and operation. Financing would be the subject of a separate competition. A DBFO contract would then be signed.



**Figure 1**  
**SCHEMES PRE PUBLIC INQUIRY ORDERS**  
**ILLUSTRATIVE PROGRAMME**



**Figure 2**  
**SCHEMES NOT SUBJECT TO PUBLIC INQUIRY**  
**ILLUSTRATIVE PROGRAMMES**



**4.7** As well as securing an optimally designed and priced product, the Agency perceives the main benefits of adopting the EDB approach in DBFO projects as:

- Speeding up the project development time to achieve early delivery. The preceding pages provide two illustrative programmes.
- Enabling the supplier to have a significant input before draft Orders are published during the Public Inquiry stage.
- Allowing the supplier maximum opportunity to introduce innovation and value engineered savings.
- Lowering the transaction costs at tender stage for all parties

**4.8** Applying EDB principles to DBFO could present the following concerns:

- Difficulties in demonstrating that best value is being achieved
- Risk of failure to deliver and raise finance
- Risk of failure to novate the supplier to the DBFO company on appropriate terms (Option 1)

## **Improving flexibility in the Contract**

**4.9** The Agency has ideas for improving the flexibility of the DBFO contract. Introducing change under the existing DBFO contract is relatively straightforward, but agreeing a price for the consequential operation and maintenance over the remaining years of the contract could be difficult.

Possible solutions could include :

- The introduction of benchmarking and market testing mechanisms to assess a project's performance against market practice. Such provisions would consider comparing the cost of services (e.g. highway cleansing, maintenance of roadside vegetation etc.) with the prevailing market and realigning the price charged by the DBFO company for these services with the market price.
- The introduction of periodic reviews at fixed intervals, which would consider the requirements of the project (e.g. review of the Output Specification) and reset them as necessary. Following a periodic review, there would need to be an adjustment to payments to reflect changes in requirements.
- As one of the difficulties with change is agreeing its long term consequences, there could be a sharing of benefit, and downside, on maintenance costs following a change.

- Facilitating more flexible financing. One of the potential difficulties in raising significant further capital during the life of a DBFO project is that it is likely that the debt raised at the outset will be on a fixed interest rate basis with potentially significant breakage costs. Probably the key problem with debt funding of these schemes is that the lenders place restrictive covenants on the DBFO company preventing it from extending its commitments.

Therefore when changes arise, it may often be difficult for the DBFO company to secure reasonable debt funding terms. There may be benefit in structures whereby the DBFO company raises finance on a floating rate basis. This might entail the Agency retaining interest rate risk.



  
 questions

Here is a list of questions to which the Agency would like you to respond. Please do not feel obliged to answer all questions. In addition, the Agency welcomes any other comments that you may have.

### **Background**

- 1** What are your views on the size and the types of projects that would be appropriate to secure better value via the DBFO procurement and why?

### **Improving the tender process**

- 2** What are your views on improving the tender stages as suggested in **4.4**?
- 3** What further steps should the Agency take to improve the efficiency of the tender process to speed up delivery and reduce tender costs?

### **Starting earlier**

- 4** In relation to extending the EDB approach to DBFO projects
  - a. What are your views on the Highways Agency's ideas for awarding the contract at an earlier stage in the project development?
  - b. How can it be made to work?
  - c. Do you agree with the analysis of the benefits this could deliver? What other benefits would you suggest may be available?
  - d. What comments do you have on the quality / price basis for the selection referred in **4.5**?
  - e. What suggestions do you have for overcoming the Agency's concerns referred in **4.8**? What other concerns do you have?
  - f. Prior to commencement of the statutory processes, what minimum level of project detail and data would be required to enable tenderers to submit a price (for both capital and maintenance works)?
  - g. What tender period do you think would be required?
  - h. How should the final price be developed whilst achieving the Objectives referred in section 2 ?

- i. What in your view is the scope for target cost arrangements and pain/gain share?
- j. What do you consider would be the advantages and disadvantages of carrying out a finance competition following agreement of the price?

### **Improving flexibility in the Contract**

- 5** What comments do you have regarding the Agency's ideas for improving flexibility mentioned in **4.9**?
- 6** What are the constraints on securing greater flexibility within DBFO contracts?
- 7** What would you suggest to improve flexibility in the DBFO contract?
- 8** What suggestions do you have for developing alternative, bankable, financing structures, which avoid some of the rigidities of the "classic" limited recourse structure?
- 9** How would you suggest risk allocation/management be revised to secure greater flexibility and / or value for money?



## Bibliography

**DETR (2000)** Transport 2010: the 10 Year Plan, Published in 2000 available on [www.dft.gov.uk](http://www.dft.gov.uk).

**Highways Agency (2001)** Delivering best value solutions and services, Highways Agency Procurement Strategy Document.

## Glossary

**TPI** Targeted Programme of Improvements for major schemes each of which has a capital value over £5 million.

**DBFO** Design, Build, Finance and Operate. A private finance contract under the Government's Public Private Partnership initiative.

**SPV** Special Purpose Vehicle – set up to implement the DBFO project i.e. a DBFO company.

**ECI** Early Contractor Involvement.

**EDB** Early Design and Build. This is a new form of contract where the supplier (usually a JV of contractor and designer) is appointed at the earliest opportunity in the scheme's life, normally just after the preferred route announcement. This gives the supplier responsibility for developing the scheme through its various stages, including layout design, order publication, public inquiry, Secretary of State's decision, detailed design, construction, handover procedure and defects correction period.

EDB follows the principles advocated by Sir John Egan in his report "Rethinking Construction". Payment is based on target costs with pain / gain share mechanisms.

Suppliers are appointed predominantly on the basis of quality and, to the extent possible, price. Tenderers are assessed on the basis of how they will cope with identified risks falling under a number of Key Performance Indicators drawn from the Client's Charter. These same KPIs will be monitored during the design and build stages of the scheme.



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