



National Health Service in Scotland
Management Executive

St. Andrew's House
Edinburgh EH1 3DG

Dear Colleague

**COMPETITION AND THE PRIVATE FINANCE
INITIATIVE
A CONSULTATION NOTE FROM HM TREASURY**

Summary

1. This MEL is to bring the attached Treasury consultation note to your attention, so that we do not miss the opportunity to comment before the deadline of 29 October.

Action

2. If you have experience of difficulties in initiating private finance schemes which could have been influenced by the rules on competition, you may like to consider how these difficulties should be taken into account. Any views on the points raised in the note should be sent to Alasdair Pinkerton no later than 25 October. This will allow time to co-ordinate a timeous response to HM Treasury.

3. The purpose of the Private Finance Initiative is to encourage the involvement of the private sector in the business of providing high quality, good value, public services. Competition between alternative providers is, in general, a spur to quality and value, and in many cases is required by EC procurement rules. There are, however, wider issues to be considered. These include the terms upon which providers are asked to compete, the ownership of intellectual property, and the encouragement of innovation. The attached note makes suggestions which could be of benefit to both the public and private sectors and raises questions on which it would be helpful to receive views.

Yours sincerely

D J PALMER
Deputy Director of Finance

13 October 1993

Addressees

For action:

General Managers,
Health Boards
General Managers,
Common Services Agency
General Manager,
Health Education Board
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General Manager, State
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Chief Executives, and
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Designate, NHS Trusts

For information:

Director of Finance;
Health Boards; CSA;
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To be copied to Unit
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Enquiries to:

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COMPETITION AND THE PRIVATE FINANCE INITIATIVE

A consultation note

Summary

This consultation note seeks to examine the practical implications of competition for the private finance initiative; it identifies some special situations where it may be necessary to stimulate more private sector activity and innovation; and it sets out a possible framework for making payments to unsuccessful participants.

2. Comments should reach the Treasury's Private Finance Unit, Room 99/3, HM Treasury, Parliament Street, London, SW1P 3AG, by Friday 29 October. They will be treated as provided in confidence, but may be drawn upon in publishing a summary of the views expressed.

Background

3. The purpose of the private finance initiative is to encourage the involvement of the private sector in the business of providing high quality, good value, public services. As the Chancellor pointed out in his speech to the Scottish CBI on 9 September, if private sector participation can improve infrastructure, make British industry more competitive and British public services more efficient, it does not matter whether ownership of the capital assets lies with the public or the private sector.

4. The Government believes that, in most cases, it will be better able to discharge its responsibility for quality and value if it gives itself a choice of providers and encourages competition between them for the business of providing the capital investment and management. Above certain thresholds competition is in many cases required by EC procurement rules covering the public sector and the utilities.

5. Despite its clear preference for competition the Government recognises that there are other considerations which also need to be taken into account:

– the success of the private finance initiative depends on the development of a competitive market among providers; if the terms

of competition are thought to be unreasonable, competition will not emerge;

– a key question in the minds of many competitors is the ownership of and rights to the solutions to problems proposed by individual bidders in the competitive process.

6. The Government therefore recognises that it is important for departments to structure the competitive process in a way which both stimulates private sector interest and which protects the legitimate interests of participants. This can best be achieved by:

(a) focusing the competitive process more sharply.

However, in some cases even this may not be sufficient to encourage private sector promoters to come forward with innovative proposals and solutions. In such cases possible steps which the Government might take include:

(b) in some complex projects, providing for the partial reimbursement of tendering costs;

(c) in some projects, offering "design only contracts"; and

(d) in certain exceptional cases, relaxing the competition requirement. The following describes the above in more detail.

(a) Focusing the competitive process

7. The Government considers that for each project or service a competition must be based on:

– a clear specification based on final outputs which leave a contractor opportunity to offer ideas;

– a clear and precise statement of the rights, obligations and responsibilities of each of the parties;

– a level playing field with clear evaluation criteria for solutions and few variables; and

– a structure which offers the private sector opportunity and reward commensurate with risk.

8. Much of this speaks for itself. It is wholly in the interests of both purchaser and contractor to limit the range of variables which are subject to competition. It engenders confidence in the process, makes the bidding process cheaper, and makes it easier for the purchaser to assess the relative merits of the participating contractors. It makes little sense, however, to insist that a particular model of provision is followed if a contractor evolves an alternative approach which is better able to deliver the purchaser's objectives. The Government therefore believes that public sector purchasers will usually wish to limit the scope of a competition to

its key variables, and to focus on final outputs. Innovation will come in the way those outputs are delivered.

9. A further means of focusing the competitive process and stimulating ideas is through pre-competitive discussions with the public sector purchaser. The Government recognises that circumstances may arise where a purchaser's interests are served by pursuing discussions with a particular contractor or group of contractors which require both sides to commit considerable resources to the process. Such discussions may, for example, explore ideas for redeveloping existing property to allow the contractor to offer services on an attractive basis to the purchaser, at the same time as offering services to private sector customers. Alternatively, such discussions may involve the bringing together of a number of different service providers by linking proposals in a package.

10. In most cases it is possible to engage in such discussions and then have a competition. In these circumstances contractors who have developed new and attractive ideas can expect to be included in the short-list. The work already done should mean that those concerned have a good chance of winning the contract.

11. The Government expects that the majority of competitions held under the private finance initiative will be for design, build and operate (DBO) contracts. It is the potential synergies and efficiencies from marrying the design of a privately-financed project to its ultimate operation which the initiative seeks to exploit. In these circumstances would-be contractors are using their design expertise to seek to secure for themselves the right to operate a particular scheme. The assumption should be that the contents of bids in these circumstances remain the property of the bidder and are not available to be used by other contractors, except on terms agreed with the bidder.

**(b) Reimbursement
of tendering
costs**

12. DBO contracts can be, by their very nature, highly complex. In certain cases departments may wish to consider whether they should help stimulate competition and the flow of ideas by arranging for contributions to be made to the costs incurred by a restricted number of pre-qualified bidders in assembling a bid. This would recognise the high costs that can arise when the private sector is responsible for bidding for the whole of a project, including its management and financing, or where a whole new way of doing things is involved. The amount of any contribution might be limited to no more than half an unsuccessful bidder's expenses. The unsuccessful bidder would in these circumstances be required to allow the use by others of relevant intellectual property.

**(c) Design-only
contracts**

13. In the case of some projects it may be unreasonable to expect a would-be contractor to continue to commit the resources necessary to make a success of pre-competitive discussions of the kind outlined in paragraph 9 above without some commitment on the part of the purchaser. In such circumstances it may be possible to offer a "design only" contract. Given the advantages of design, build and operate contracts, "design only" contracts should be the exception rather than the

norm. In such cases the Government would normally expect the right to the intellectual property contained in individual bids to pass to the purchaser. It would also be desirable for at least part of the remuneration of the winner of such a contract to depend on the value attached to the scheme in any later competition among would-be operators. The Government believes that the placing of design only contracts should be a public event, and that the essential terms of the contract - including the basis of remuneration - should be publicised. This publicity would ensure that all the parties to the discussions and the wider public are fully aware of the terms on which the project is proceeding.

(d) Relaxation of competition

14. In certain exceptional cases it is possible that even the approach outlined in paragraphs 9-13 above may not provide an adequate basis for discussions to proceed between purchaser and would-be contractor. It might be, for example, that an operating contract could only proceed on the basis of access to the physical and intellectual property of the contractor and that the contractor is not willing to grant a competitor access to his property.

15. One proposal that has been put, is that if it can be demonstrated that, such considerations are likely to render any later competition nugatory, the Government should be willing, subject to the requirements of EC rules, to consider allowing purchasers to place design, build and operate contracts without the requirement for competition. The following minimum conditions would need to be satisfied:

a. the purchaser can demonstrate that the service offered by the contractor is better value than the service currently available to him, and that the terms on offer are at least comparable to those available for a similar service in similar circumstances elsewhere;

b. the terms of the contract are publicised; and

c. a period of at least 90 days is allowed between publication of the terms of the contract and its coming into force, to allow any competitor contractor who wishes to do so to offer an alternative basis for providing the service required by the purchaser.

Post-competitive revisions

16. The approach to competition set out above should mean that the outcome of performance-based competitions is not significantly altered after the initial tenders are submitted. There may be circumstances, however, where changes in the original specification require a fresh competition to be held. The bidder who was successful in the initial competition can expect to be short-listed in the new competition. If that bidder is then unsuccessful, payments might be made for ideas developed in discussion prior to the second competition, and some form of recompense made for expenses incurred in the first competition.

Terms of remuneration

17. Under the proposals in this note contractors may be remunerated directly for the use of their intellectual property in the following circumstances:

- a. when a contractor has submitted an unsuccessful bid in a competition for a design, build and operate contract, and subsequently agrees to allow the successful bidder access to his intellectual property (paragraph 11);
- b. in a design-only contract, where the intellectual property is provided to the purchaser (paragraph 13).

In addition, contributions might be made towards tender costs under paragraphs 12 and 16.

18. Payments of remuneration to contractors under the terms of this note may take a number of forms, including:

- payments of a lump sum;
- payments which depend on the success of the project;
- the right to an equity participation in a project.

19. In the circumstances envisaged in this note (other than those involving the payment towards tender costs), purchasers may prefer payment methods which reflect the worth of particular ideas, rather than simply the cost of their development. Departmental Accounting Officers will however need to be able to justify payments on the basis of ascertainable factors.

20. Departments will need to establish a hierarchy of authorisation levels for payments of this kind. They may also wish to consider setting up independent panels of experts to advise on the value of particular types of intellectual property, particularly in the context of the arrangements envisaged in paragraph 11.

Questions

21. Comments are invited on the analysis above. In particular, comments are invited in response to the following questions:

- what are the key parameters of a workable competitive process? (paragraph 7);
- what scope exists for unsuccessful bidders to agree terms with successful bidders for access to their intellectual property? (paragraph 11).
- would the partial reimbursement of tendering costs in certain cases help to encourage competition? (paragraphs 12 and 16)

– in what circumstances should purchasers use design-only contracts? (paragraph 13).

– would the relaxation of competition in certain cases help to encourage innovation? (paragraph 14)

– how should remuneration of contractors for the use of their intellectual property be structured? (paragraph 18)

– what scope exists for basing remuneration on the value rather than the cost of ideas? Can this approach be reconciled with the Accounting Officer's need to base payments on ascertainable factors? (paragraph 19)

– would independent panels of experts assist this process? (paragraph 20)

HM Treasury

September 1993