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*Halton Borough Council
Mersey Gateway
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Mersey Gateway

The Council's Response to Feedback

Received During Consultation

DRAFT

KPMG LLP

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This report contains 9 pages

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1 Introduction

Halton Borough Council completed a market consultation exercise relating to the Mersey Gateway Project in February and March 2011. The consultation included the circulation of a Project Information Memorandum (“PIM”) to potential bidders and an industry day followed by an invitation to submit written responses to specific matters raised in the PIM.

The Council welcomes the feedback that has been provided by potential bidders and thanks them for taking the time to help the Council tailor the scheme details before the formal launch of procurement.

The Council is encouraged by both the quality of the consortia and their level of interest in the Project. The Project remains the number one priority for the Council and the region and, with this in mind, all issues raised have been reviewed carefully. Following this review, the Council has taken onboard a number of key messages from the market and has made some adjustments to the approach to certain matters. This document summarises the responses received from the market and how the Council’s approach has evolved as a result of these.

2 Procurement Process

We asked...

...for your views on the process proposed to be adopted for the procurement. In particular, we sought comments on the adoption of a competitive dialogue process and the specifics of that process.

You said...

- A bid workshop at the commencement of dialogue would assist in identifying the key interdependencies and interfaces and mapping out a process and programme;
- The clarifications procedure should be closed early in advance of the tender submission, to avoid material changes at the end of the process which could have a significant impact on the developed bid proposals;
- All phases of the process must be accompanied by a clear indication of the proposed evaluation criteria; and
- Interim submissions during the competitive dialogue process should be kept to a minimum.

We are listening and are doing the following to address the feedback...

- We have confirmed that we intend to qualify 3 bidders from the PQQ evaluation stage to take forward to the competitive dialogue stage in order to strike the right balance between providing each party with an adequate chance of being awarded the contract whilst ensuring a robust competition;
- We have confirmed that the dialogue period will commence with a number of bidder briefings;
- We have confirmed that we will only require a very limited number of formal submissions during the competitive dialogue;
- We have developed a straightforward approach to evaluation that is very much price focussed once minimum quality thresholds are met. The detailed criteria will be shared with bidders from the outset in the tender documentation;
- We have established a tightly controlled process for the administration of the dialogue stage to ensure focussed and productive meetings that stay on topic and we will be clear throughout with regard to which matters are not for debate. Agendas will be circulated for comment in advance, meetings will be recorded and bidders will be given appropriate time to act on the decisions taken during the dialogue sessions; and
- With regard to the involvement of funders during the procurement, more information is provided in Section 9.1 of this document. We have, however, noted comments received with regard to ensuring the right incentives for funders during the dialogue process and can confirm that if a funding competition were to be required at preferred bidder stage then the bidder's funders will have the right to match the revised terms for 50% of the project debt.

3 Payment Mechanism

We asked...

...for your views on the proposed payment mechanism. In particular, we sought comments on the specific elements of the proposed mechanism including the journey time, performance and revenue reconciliation aspects.

You said...

- Factors outside the Project Company's control need to be recognised;
- The rate of pavement deterioration depends on the traffic mix and in particular the volume of heavy goods vehicles. The payment mechanism needs to account for this lifecycle cost risk;
- It will be the Council's desire to increase traffic volume and therefore revenue generation. This objective will be shared by the bidders however, they will be looking for protection in terms of the knock on effect of increased volumes on journey times, and potentially on increased operational and maintenance costs.

We are listening and are doing the following to address the feedback...

- The Council is taking these messages onboard as the payment mechanism is developed and agrees that there are elements of commercial risk that are best shared with or retained by the Council. The following instances are now envisaged to result in an adjustment to the baseline Unitary Charge (“UC”):
 - Transactions being above or below a prescribed range around the baseline estimate of traffic volume, to take account of the impact on toll collection costs; and
 - Heavy Goods Vehicle usage being above or below a prescribed range around the baseline estimate, to take account of the impact on maintenance costs.
- With regard to the journey time element of the payment mechanism, the primary objective is to incentivise efficient, well-managed operation of the Project, supported by the appropriate influence of operation risk on scheme design, and recognise that poor operational service by the Project Company (as manifest by delays to users) will have an impact on the Council’s toll revenue (and therefore the mechanism reduces the UC to reflect that failure in service). The mechanism is not intended to reduce the UC if the delays are the result of demand exceeding the design capacity and there will be a defined list of circumstances that qualify as relief events.

4 Contaminated Land

We asked...

...for your views on the approach to contaminated land. In particular, we sought comments on the work performed to date, risk transfer and the approach going forwards.

You said...

- Undertaking advance remediation works in a number of complex areas would be beneficial for the project; in particular, where in-situ remediation is required and the programme for these works may need to be extended to achieve the required clean up levels. It would significantly reduce the risks to the main project programme to ensure that these works were complete in advance of main works commencement;
- The regulators must be involved throughout the development of the detailed design to ensure that their requirements are met before a design solution is committed to for the project. The availability of the regulators for discussion with bidders during the procurement process will be essential;
- It should be recognised that it will be appropriate to transfer risk to the Project Company only where that risk is reasonably quantifiable and can be adequately priced; and
- Bidders will need to understand further the mechanism for technical due diligence for the scheme prior to financial close, to reach satisfaction for themselves and their funders that the design proposals will close-out these risks as far as practicable during design and construction, in addition to obtaining the relevant regulatory approvals.

We are listening and are doing the following to address the feedback...

- Remediation as part of the advance works is being progressed at the Catalyst Trade Park site, and we are aiming to have this completed in advance of the main works commencement;
- The need to undertake more remediation in advance of financial close is being investigated and will take into account the results of additional ground investigation;
- The views of the regulator are reflected in the above actions and the remediation requirements are expected to be clearly defined so that the Project Company is in a position to take responsibility for mitigating the effects of contamination due to the design and construction of the scheme;
- The Council has continued to liaise with the environmental regulators and acknowledges the fact that they will need to be involved in the design and tender processes. This has been discussed with the regulators and a mechanism will be put in place to ensure that appropriate consultation can take place during the procurement and design process; and
- The Council is conscious of the issue of risk transfer and the need for technical due diligence with regard to contaminated land and is developing an approach to ensure that this can be adequately accommodated.

5 Tolling Infrastructure

We asked...

...for your views on the approach to tolling infrastructure. In particular, we sought comments on the relative merits and viability of barrier tolling versus Open Road Tolling and alternative concepts.

You said...

- A procurement process that is flexible to incorporate ORT from day one, should legislative change support this, could offer significant benefits for the Project, particularly in terms of level of service and capital cost savings, as well as in terms of reduced risk profile complexity (when compared to introduction at a later stage); and
- Violations risk must be properly addressed before a potential migration to ORT.

We are listening and are doing the following to address the feedback...

- The Council agrees with the market sentiment to remain flexible with regard to the optimum tolling solution and discussions are continuing around how this might be best achieved;

- The Council has now completed and approved its final business case analysis of the optimum solution to tolling technology. The findings are finely balanced and are swayed by the trade off between capital and operational cost savings and the potential for additional revenue leakage risk; and
- It is recognised that throughout the dialogue process tolling technology will remain a key topic for discussion and where bidders can offer innovative, good-value solutions in an Open Road Tolling context then the Council will be very interested in discussing those proposals.

6 Operational Governance Arrangements

We asked...

...for your views on the approach to operational governance arrangements. In particular, we sought an indication of willingness to participate in the Mersey Gateway Crossings Board (MGCB) structure via an equity contribution and possible sharing in revenue risk.

You said...

- The consortium would like to understand the support from the Council and Department for Transport to the MGCB in the event of shortfall in toll revenues impacting on the operation of the project;
- There might be opportunities to add value to the project and increase the incentives for the private partner if the MGCB is structured as a joint venture between the public and private partners; and
- The lenders will need to understand the intended role of the MGCB and the intended scope of its powers.

We are listening and are doing the following to address the feedback...

- We have been very pleased at the support for the concept of the MGCB and can confirm it is the preferred delivery vehicle for the operational governance of the project;
- The MGCB will be established on an arms-length basis from the Council and will enter into the Project Agreement with the Project Company for the term of the Project. The Council is expecting to financially guarantee the obligations of the MGCB to the Project Company. Income from tolls and payments from the Department for Transport will be paid to the Board and the Unitary Charge payments due to the Project Company will be paid by the Board. In short, the Board will be responsible for the management of the contract with the Project Company and the cash flows that relate to it as well as the management of the Council's obligations under the contract and the monitoring function. Bidders will be asked to bid to support the work of the Board both through the provision of expertise in the management of the crossing and the tolling strategy in exchange for access to a proportion of surplus toll revenues; and

- An approach to procurement and evaluation which will take account of bidders' offers to participate in the MGCB will be developed. This information will be shared with bidders in the tender documentation issued at the start of procurement.

7 **Advance Works**

We asked...

...for your views on the scope of advance works. In particular, we sought comments on the studies performed to date and what was needed going forwards.

You said...

- It is vital that bidders will be provided with full details of the scope of these contracts and the performance guarantees being sought from the advance works contractors; and
- That the following should be included in the advance works:
 - Demolition and vegetation clearance (the ecological surveys should include bat surveys of buildings to be demolished and if major roosts are identified the provision of alternative roost sites);
 - Selected utility diversions, to the extent that they can currently be identified;
 - Selected remediation;
 - Full asset surveys of all existing infrastructure that will become the responsibility of the Project Company, including drainage; and
 - Surveys for unexploded ordnance.

We are listening and are doing the following to address the feedback...

- We are conscious of the benefits of obtaining warranties from advance works contractors and this is being taken into account in the procurement of these works;
- Demolition of selected structures and some vegetation clearance is planned where it is necessary to facilitate any advance works. Consideration will be given to the need for further vegetation clearance in advance as appropriate;
- Ecological surveys are ongoing to provide survey data that meets the requirements of the planning conditions in terms of pre commencement surveys and where appropriate these will include bat surveys;
- Selected utility diversions are being progressed as part of the advance works and we are also continuing our dialogue with the utilities companies and providers to progress this matter;
- Selected remediation is being progressed as part of the advance works (this is discussed in more detail in Section 4 above); and

- A detailed desk study into the issue of unexploded ordnance is to be undertaken to clarify the risks. On the basis of the outcome of this study the Council will consider what further investigations of this issue need to be carried out as part of the advance works.

8 Alternative Contractual and Risk Sharing Arrangements

- The Council welcomes and is encouraged by the level of innovation demonstrated in the feedback with regard to how the Project Company might share in revenue risk via participation in the Mersey Gateway Crossings Board or an alternative arrangement. Please see Section 6 for a discussion of the chosen framework.

9 Additional Issues Raised

9.1 Lender Involvement

- When viewed in aggregate, the feedback expressed that achieving enforceable, firm commitments from banks at Final Tender would not be practicable and a number of recommendations were put forward that have been deemed beneficial to the Project. The Council is now able to offer greater detail on how lenders are envisioned to be involved, drawing on the ideas submitted:
 - The Council agrees with the premise that obtaining enforceable firm commitments from banks at Final Submission Stage is not practicable. Instead, the Council would like to see a ‘relationship banking’ approach from bidders for the Project. Each consortium will be expected to select a Core Bank Group prior to bid submission and through these banks effectively have a significant portion (minimum requirement to be confirmed) of the senior debt requirement covered. The successful bidder and its Core Bank Group would then be responsible for obtaining commitments for the rest of the debt funding requirement during the Preferred Bidder stage.
 - The Core Bank Group would be expected to be made up of experienced project finance lenders and would be required to undertake detailed due diligence and sign-off on the key commercial and financial parameters of the bid so that any matters of concern are brought to the attention of the Council at the bidding stage. The Council will require evidence indicating the extent of work performed by the Core Bank Group and the robustness of its due diligence sign-off. The Council will likely reserve the right to hold a funding competition to potentially improve the funding terms if deemed appropriate. There would, however, be a “right to match” provision for 50% of the debt to incentivise the necessary due diligence work by the bank.