

Board Paper

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Board function:	Significant planning, investment and operational matters
Subject:	Procurement approval for state highway PPPs

Introduction

- 1 The consideration of an alternative procurement method, public private partnership (PPP), for the Transmission Gully component of the Wellington Northern Corridor Road of National Significance was the subject of two papers to the September 2012 NZTA Board meeting. The first (Board paper 12/09/681) addressed funding and procurement matters and the second addressed the detailed business case to support the public private partnership delivery model (Board paper 12/09/682). The Board was advised that a paper seeking formal approval of a state highway PPP procurement procedure would be brought to its October 2012 meeting

Purpose

- 2 To seek the Board's approval of a customised procurement procedure for use by the NZTA to procure works and services to deliver future state highway projects through a PPP.

Recommendation

- 3 That the New Zealand Transport Agency Board **approves**, under section 25(1) of the Land Transport Management Act 2003, the *NZTA state highway Public Private Partnership procurement procedure* (Attachment 1 to Board paper 12/10/0689) for use by the NZTA for selected major infrastructure projects.

Background

- 4 One of the Board's statutory independent functions under the Land Transport Management Act 2003 (LTMA) is the approval of procurement procedures. The NZTA's *Procurement manual for activities funded through the National Land Transport Programme* contains four procurement procedures which cover most procurement activity. Approved organisations, and the NZTA, are able

to use those approved procurement procedures providing they have an NZTA endorsed procurement strategy in place and procure in accordance with their strategy.

- 5 The procurement procedures in the NZTA's Procurement manual do not cover PPPs. The manual anticipates that some procurement events will require a customised procurement procedure to be specifically approved by the NZTA under section 25 of the Land Transport Management Act 2003 (the LTMA).
- 6 To procure projects like Transmission Gully through a PPP the NZTA therefore needs both an endorsed procurement strategy which covers the use of PPPs and an approved customised procurement procedure.

Procurement strategy for state highway activities

- 7 The NZTA has a procurement strategy in place for the procurement of state highway activities, endorsed by the NZTA Board on 27 August 2010. The strategy consists of an overarching *State Highway Portfolio Procurement Strategy 2010* (the PoPS) with more detailed strategies for particular groups of activity and for large projects. These more detailed strategies are referred to in PoPS as *Stage 1 Procurement strategies*. For large projects they are prepared as and when required and are endorsed under delegated authority. The PoPS discusses PPPs noting that a PPP uses a form of the design and construct delivery model. The discussion of PPPs is found in section 3.3.3 *Public Private Partnerships* attached to this Board paper (Attachment 2).
- 8 Much of the work, including engagement with the supplier community, required to prepare a procurement strategy for a Transmission Gully PPP has been done. When the strategy is finalised it will be taken to the HNO's Value Assurance Committee (the VAC) for endorsement under delegated authority.

- 9 Through this paper we seek the Board's approval under section 25 of the LTMA for the attached customised procurement procedure – the *NZTA state highway PPP procurement procedure* (Attachment 1).
- 10 We anticipate that all future NZTA PPP procured projects, including Transmission Gully, will use this customised procurement procedure. Any PPP arrangement would require its own Stage 1 Procurement strategy and that strategy would be considered for endorsement by the VAC under delegated authority. Subject to the actual procurement procedure detail complying with the requirements set out in Attachment 1, no further LTMA section 25 procurement procedure approval would be required.

Structure and content of the attached procurement procedure

- 11 The procurement procedure (Attachment 1) is built around the expectation that PPP procurement by the NZTA will proceed in a way that is consistent with the principles that underpin the NZTA's *Procurement manual*, which include the principles which are expressed through the LTMA section 25. This PPP procurement procedure makes reference to Chapter 6 in the NZTA's *Procurement manual*, the Infrastructure procurement procedure, and states that procurement through a PPP will be consistent with Chapter 6 and with the procurement rules set out in Chapter 10 of the manual except where the procurement procedure states otherwise.
- 12 The PPP procurement procedure outlines areas where it may depart from either Chapter 6 or the rules in Chapter 10 but does not describe each departure in detail. Rather it establishes that normal internal NZTA processes will be applied and that all procurement procedure design detail must be to the satisfaction of the Chief Executive. Established delegations to subordinate NZTA staff and the NZTA's significance policy will apply.

13 Specific features to note about the procurement procedure (Attachment 1) including areas where it will depart from either *Procurement manual* Chapter 6 or the rules in Chapter 10 are as follows:

- The PPP delivery model will be based on the design and build delivery model and will include some if not all maintenance, operation and renewal.
- The term of the contract established between the NZTA and the supplier will cover the design and construction period plus the operation phase up to 25 years - or more if better value for money would be obtained through a longer term.
- The supplier selection process will begin as an open competition and may include one or more subsequent 'short listing' processes.
- The supplier selection process will be based on the price quality method. Non-price attributes may not include all three of the compulsory attributes (relevant experience, relevant skills and methodology) as they are defined in the *Procurement manual*. Alternatively they may be adapted to better suit PPP procurement. The attributes required of a PPP supply team will be different to those required when the purchaser is not providing the finance.
- Price weight may depart from the usual range of 10 to 70. Later stages in the supplier selection process (following short listing) may need to place greater emphasis on price than a 70 weight permits. The *Procurement manual* allows the early stages, to short list, to be based on supplier non-price attributes alone - using in effect a price weight of nil.
- The 'two envelope' system may be modified, including by allowing the 'price' envelope to be evaluated in parallel with other non-price information, while continuing to be fair to all who submit proposals and following the process set out in the request for proposals (RFP). The

standard two envelope system is sequential. All non-price information is evaluated before the price envelopes are opened. This helps to ensure that the process is fair. The proposal evaluation team evaluates non-price matters without the risk of being influenced by knowledge of price. For complex procurement more elaborate ways to evaluate proposals, while continuing to ensure fairness, are often used.

- The supplier selection process may include negotiation of contract terms and conditions, including price, following the process set out in the RFP.
- The RFP will include a provision to allow the supplier selection process for delivery through a PPP to be abandoned if the best PPP offer cannot show a better whole of life cost for the project than has been stated in the RFP as the affordability limit.

Assessment of the NZTA's procurement procedure for PPPs

- 14 Section 25(1) of the LTMA sets out that the principal consideration for the NZTA is to approve procurement procedures that are - 'designed to obtain the best value for money spent by the Agency and approved organisations, having regard to the purpose' of the LTMA. In its approval process the NZTA is required to also have regard to the desirability of enabling fair competition amongst those willing and able to provide outputs required for approved activities and 'encouraging competitive and efficient markets', for the supply of those outputs.
- 15 Use of PPPs by the NZTA in accordance with the attached procurement procedure is measured against these section 25 'tests' below:
 - **Best value for money** – The principal aim of PPP procurement is to obtain better value for money than any alternative as demonstrated through the public sector comparator (PSC)

mechanism developed in accordance with the Treasury guidelines including the *Better Business Case Approach* and *Guidance for PPPs in New Zealand*. Best value for money must be considered having regard to the purpose of the LTMA: the NZTA's proposal to use PPP procurement is consistent with the Act's purpose.

- **Enabling competition that is fair** – The supplier selection process will begin as an open competition amongst all who wish to participate – competition is therefore enabled. The process of supplier selection will be conducted so as to be fair to all who participate.
- **Encouraging competitive and efficient markets for supply** – Work to date with the supplier community has shown that there are a number of suppliers who are willing to compete to be PPP suppliers to the NZTA. A PPP has the potential, by virtue of the scale of the contract and the commercial opportunities it offers to bidders, to encourage entry of one or more new players to the New Zealand market. The term of a PPP contract is very long. If the work required to operate or maintain the asset were delivered by one supplier across its full term others would be deprived of the opportunity to more regularly compete for the work. However, the proportion of the nation's roads that will be under a PPP contract at any point in time is likely to be small and it is probable that operations and maintenance work would be subcontracted and the subcontractor could change several times over the concession period depending on who is best able at any time to offer the best value for money.

16 We conclude that the proposed procurement procedure (Attachment 1) is designed to obtain the best value for money and meets the LTMA section 25 tests. This conclusion is based on the assumption that a PPP will only be used where the PSC mechanism has shown that PPP procurement offers best value for money. In drawing this conclusion we have also had particular regard to the fact that purchasing maintenance and operations services from the same PPP supplier for 25 or more years is unlikely to have any materially adverse affect on competition within supply markets.

17 We therefore recommend that the Board approve, under section 25(1) of the LTMA, the procurement procedure entitled *NZTA state highway PPP procurement procedure* (Attachment1).

Communication and engagement

18 No specific communications are planned around the approval of an NZTA PPP procurement procedure. Informal discussions are ongoing with suppliers around the Transmission Gully project as a PPP and more formal market sounding is proposed following consideration of Transmission Gully by the Cabinet.

Attachments

19 There are two attachments:

- Attachment 1 - NZTA state highway PPP procurement procedure
- Attachment 2 - Section 3.3.3 *Public Private Partnerships* from the *State Highway Portfolio Procurement Strategy 2010*

Attachment 1

NZTA state highway PPP procurement procedure

Introduction

1. This procurement procedure is for the purchase of road infrastructure including its maintenance operation and renewal through a public private partnership (PPP) contract. It is approved by the NZTA under section 25(1) of the Land Transport Management Act 2003 (LTMA).

Context

2. The NZTA intends to procure certain road infrastructure projects using PPP contracts. The NZTA's Procurement manual does not include an approved procurement procedure that is intended to be used when delivery will be through a PPP. A customised procurement procedure, approved by the NZTA under section 25 of the LTMA, is therefore required.
3. The NZTA has endorsed the use of a PPP procurement procedure for the Transmission Gully project subject to a number of conditions.. This procurement procedure may be used for this project and for any future NZTA state highway projects which the NZTA Board agrees will be procured through a PPP.
4. This procurement procedure is designed to obtain the best value for the money to be spent through a PPP on the purchase of state highway infrastructure plus, for the period of the concession, part or all of its maintenance, operation and renewal. In designing this procurement procedure the NZTA has also had regard to matters relating to competition, as anticipated by section 25(2) of the LTMA.
5. The NZTA may need to establish other contracts, in addition to a PPP contract, to deliver a particular project. This *NZTA state highway PPP procurement procedure* will not apply to those other contracts.

Reference documents

6. This procurement procedure refers to the following documents:
 - Procurement manual for activities funded through the National Land Transport Programme (NZTA)
 - State Highway Portfolio Procurement Strategy (NZTA)
 - Better Business Cases documentation (The Treasury)
 - Guidance for Public Private Partnerships (PPPs) in New Zealand (The Treasury)
 - Draft Public Private Partnership (PPP) Standard Contract (The Treasury)
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Preparation of PPP procurement documents by the NZTA

7. Procurement documentation, including any expression of interest (EOI) or request for proposals (RFP) will be prepared by the NZTA guided by the above Treasury documents. Treasury documents will be followed where possible. In the event of any inconsistency between the Treasury documents referred to above and the NZTA's Procurement manual, as varied by this procurement procedure, the NZTA's Procurement manual will prevail.
8. Procurement processes will be consistent with the State Highway Portfolio Procurement Strategy (PoPS). In particular a procurement strategy for each project to which this procurement procedure applies will be prepared and endorsed as required by the PoPS.
9. The NZTA's Procurement manual for activities funded through the National Land Transport Programme requirements will be followed, including the infrastructure procurement procedure (Chapter 6) and the rules (Chapter 10), except where varied by this procurement procedure.

Application

10. This procurement procedure will apply to the PPP contract for Transmission Gully and any future NZTA state highway projects which the NZTA Board agrees will be procured through a PPP. The procurement process and the procurement documents prepared, including the contract documents for these projects and any variations to them, must be consistent with this procurement procedure, to the satisfaction of the NZTA's Chief Executive.

Consistency with NZTA Procurement manual principles

11. Procurement under a PPP by the NZTA will proceed in a way that is consistent with the principles which underpin the NZTA's Procurement manual, which include the principles which are expressed through the LTMA section 25.

Delivery model

12. The PPP delivery model will be based on the design and build delivery model, as described in the NZTA's Procurement manual and will include some if not all maintenance, operation and renewal.

Contract term

13. The term of the contract established between the NZTA and the supplier will cover the design and construction period plus a maintenance and operation phase of up to 25 years - or more if the Chief Executive considers that greater value for money would be obtained through a longer term. This varies the rule in NZTA *Procurement manual* section 10.21 *Maximum term of a term service contract for infrastructure or planning and advice*.

Supplier selection process

14. Supplier selection will begin as an open competition and may include one or more subsequent 'short listing' processes.
15. The supplier selection method will be based on the price quality method (refer NZTA *Procurement manual Appendix C Supplier selection methods*).

16. Non price attributes may not include all three of the compulsory attributes (relevant experience, relevant skills and methodology) as they are defined in the NZTA Procurement manual. Alternatively they may be adapted to suit PPP procurement. This varies the rule in the NZTA's *Procurement manual* section 10.14 *Non-price proposal evaluation attributes*.
17. Price weight may depart from the usual range of 10 to 70. This varies the rule in NZTA *Procurement manual* section 10.15 *Price and price weight*.
18. The 'two envelope' proposal evaluation system may be modified, including by allowing the 'price' envelope to be evaluated in parallel with other non-price information, while continuing to be fair to all who submit proposals and following the process set out in the request for proposals RFP. This varies the process described in the NZTA *Procurement manual Appendix C Supplier section methods*.
19. The supplier selection process may include negotiation of contract terms and conditions, including price, following the process set out in the RFP. A negotiated change in price may or may not be accompanied by a proportionate change in the outputs to be delivered. This varies the rule in the NZTA *Procurement manual* section 10.18 *Use of negotiation in a supplier selection process*.
20. The RFP will include a provision to allow the supplier selection process for delivery through a PPP to be abandoned, if the best PPP offer cannot show a better whole of life cost for the project than the affordability limit stated in the RFP, which will be based on the public sector comparator (PSC) developed in accordance with the Treasury documents referred to above, in particular the Better Business Cases documentation and the Guidance for Public Private Partnerships (PPPs) in New Zealand.

Further departures from procurement manual rules

21. The NZTA's Chief Executive may agree to further departures from the rules presented in the NZTA's Procurement manual Chapter 10 where he is satisfied that better value for money will be obtained. The rationale for departing from a rule, expressed in LTMA section 25 best value for money procurement procedure design terms, will be documented by the NZTA.

Use of a probity auditor

22. To ensure process integrity the NZTA will use a probity auditor.

Dispute resolution

23. PPP contracts will include dispute resolution procedures.

Assignment

24. The contracts formed under this procurement procedure must include appropriate provisions to protect the interests of the NZTA in the event that another party to a contract wishes to assign any of its benefits, rights or obligations under a contract.

Reporting

25. Contracts formed under this procurement procedure must give the NZTA access, as a minimum, to sufficient information to enable it to comply with its relevant obligations including obligations to publicly report on its activities.

Attachment 2

The following is an extract from the NZTA's *State Highway Portfolio Procurement Strategy 2010*.

3.3.3 Public Private Partnerships

Public Private Partnerships (PPPs) are a form of Design Build Operate Maintain contract, involving a financial contribution from the private sector. Similar to a DC contract, a specimen design is completed, and a contract let for the completion of design and construction. However, they differ from a DC in that they include a private finance requirement as well as ongoing maintenance and operation responsibilities. Part or all of the progress payments usually made to a supplier during the construction phase are withheld until the opening of the project, and thereafter spread over the period of operation and maintenance. PPPs use predominantly outcome based specifications in order to preserve the opportunity for innovation and whole-of-life initiatives.

There are many variants of the PPP delivery model, each with a different set of contractual drivers, and each can be used to suit different situations, for example:

- Maintenance and operation periods: 20-35 year periods are common for PPP contracts, although some have been known to be let for periods of up to 100 years.
- Financing: The level of public funding during the construction phase of the project can vary from 80% to 0%, with the remainder paid during the maintenance and operation phase through either public funds or revenue generated from the project (such as direct revenue generated through road tolls).
- Traffic risk: For roading projects where toll revenue generated from the project covers repayment of financing costs, a key risk to this revenue stream is fluctuations in the volume of traffic using the new road. This is normally a critical risk for tolled PPP projects with quite different approaches available to clients to managing it.

There are four key benefits that can be had from PPP contracts:

- They can produce excellent contractual incentives for the early completion of construction of a project.
- They provide excellent opportunities for innovation in both the construction, and maintenance and operation phases of the project.
- They ensure a whole-of-life focus is taken by the supplier, readily allowing for capital and operation expenditure trade-offs in the design process, aiding the achievement of best value for money.
- If other benefits are also available, they can be used to advance projects that might otherwise have been deferred, delivering the benefits to road users much earlier.

This form of delivery model is suited for larger projects, with a significant or complex operational or maintenance requirement, and where there is plenty of scope for innovation.

The NZTA has not previously deployed this contract model on any of its projects to date. It however continues to be seriously investigated for a number of projects, including some of the projects within the current Road's of National Significance (RONs) programme.