

# Routes to Market: Smart Motorways Alliance Commercial Model Summary August 2018

## Overview:

- The proposals outlined within are draft proposals and subject to sign-off from our governance process.
- Non-participation in the market engagement exercise will not prevent participation in the procurement process.
- Participation in the market engagement exercise, and any information provided, will not be used for evaluation purposes in any future procurement processes.
- The same information will be accessible to all interested parties throughout the market engagement exercise.
- Any information/feedback provided by the market may be used by Highways England in undertaking analysis necessary for the finalisation of the delivery model.
- No information provided by Highways England within should be relied upon as a representation or commitment by Highways England for how the final Alliance model will work.

The information provided by Highways England in this document has been prepared in good faith and does not purport to be comprehensive nor independently verified. Highways England does not accept any liability or responsibility for its accuracy, adequacy or completeness, nor do they hold any representation or warranty, expressed or implied, with respect to any information provided during the market engagement exercise.

## 1 Document Purpose

This document describes the updated approach to Budget Setting and Incentivisation previously presented at the Supplier Engagement session in July 2018. The information contained within this document has considered feedback from previous market engagement to improve the model and aims to provide further detail regarding these two elements of the Smart Motorways Alliance commercial model.

This document reflects most recent developments within the Smart Motorways Alliance (SMA) and Routes to Market procurement solution. Further information will be available during the official procurement stages.

HE are seeking feedback from participants on the updated commercial arrangements for the Smart Motorways Alliance outlined in this document, specifically any key matters that would influence the participants appetite to tender or impact the structure of their future tender submission.

Please send feedback by Wednesday 5 September to the following email address:

[RTMYourQuestions@highwaysengland.co.uk](mailto:RTMYourQuestions@highwaysengland.co.uk)

## 2 Commercial Model Overview

### 2.1.1 Commercial Drivers & Objectives

The primary objective of the commercial model for the SMA contract is to create a delivery environment with shared ownership of the programme budget and a risk profile which links the Alliance Partner fee recovery (overhead and profit) to collective delivery performance.

It is anticipated that a programmatic approach will encourage standardisation of the smart motorway product and delivery solutions and hence improve the economy and efficiency with which individual schemes and consequently each Roads Investment Strategy (RIS) period are delivered. Additionally, providing suppliers more visibility of the future work bank will increase their ability to invest in innovative production techniques and building their capability on a sustainable basis.

The key objectives of the commercial model are to:

- Drive collaboration through shared objectives and key performance indicators that aggregate performance and reward individual partners at Alliance collective level.
- Provide for partner returns to be improved by delivering solutions that drive down cost below the programme budget.
- Incentivise suppliers to collaborate effectively with Highways England and each other to mitigate underperformance by sharing knowledge and resources in an open-book environment.
- Provide an incentive model which provides confidence in the contractual programme budget, and provides additional opportunity for reward. A sustainable risk profile for the Alliance partners.

### 3 Alliance Budget Setting

The SMA will be contracted to deliver the entire Smart Motorway Programme (SMP) for the balance of RIS 1, RIS 2 and RIS 3, using a single multi-party Alliance contract entered into by Highways England and all Alliance Partners. The Alliance Partners will be incentivised against the Alliance budget to deliver the key outcomes of the programme. The Alliance budget will be established from the funding settlement agreed with Department for Transport (DfT) through the following steps:

1. The Alliance scope of works will be costed utilising historic cost data with supporting quantities for those schemes with a preliminary design. Works which do not have a preliminary design developed will utilise historical costs for a typical scheme adjusted through a quantitative risk assessment for elements which are seen as ‘abnormal’.
2. An assumption of future work expected to be delivered within RIS 3 will be included in the Alliance budget with provision for efficiency that will be required to secure funding settlement from DfT. Should the forecast scope change for RIS 3 then an adjustment via change control will be applied to the Alliance budget when the settlement is reached.
3. The SMP budget will be subject to efficient commitments which will be embedded within the funding baseline (post efficient) and carried forward into the Alliance budget.
4. The budget will include all Alliance costs, partners, supply chain and Highways England (including Highways England Alliance resources) including Alliance Partner fees.
5. Inflation will be allowed for within the budget, aligned to RIS 2 settlement agreed with DfT, and a defined inflation index for RIS 3. The RIS 3 inflation allowance can be adjusted via change control when the settlement is reached.
6. All foreseeable delivery risks will be included within the budget. Adjustment to the budget is only envisaged with changes to high level client requirements.

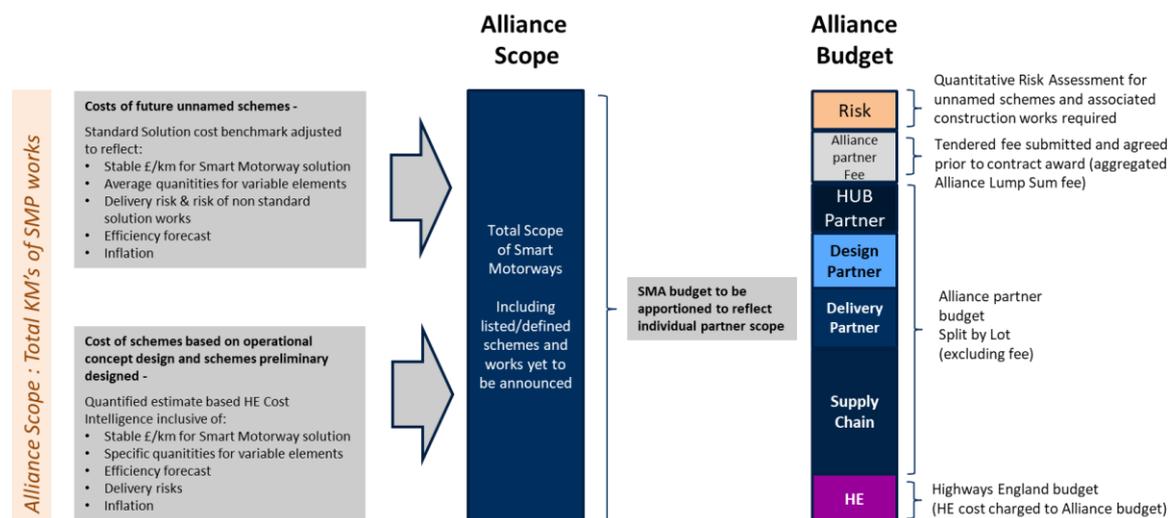


Figure 1 – Alliance budget components

## 4 Incentive Model

The Smart Motorways Alliance commercial and incentive model sets out the way in which the Alliance partners will be rewarded for achieving Highways England required outcomes. The Alliance commercial model is set up to allow Alliance Partners to recover a ‘guaranteed’ proportion of their fee and attain remaining proportions of fee based upon their ability to perform in accordance to budget and other defined objectives relating to required Highways England outcomes.

The Alliance Partners will be required to submit at tender stage a fee percentage based upon their forecast Alliance scope. This will be aggregated for all partners into an Alliance lump sum fee and paid on a regular basis in accordance with the terms of payment for each proportion of the fee and earned value achieved.

The Alliance lump sum fee will be apportioned into three individual elements; base fee proportion, Alliance goals fee proportion, and an Alliance budget fee proportion.

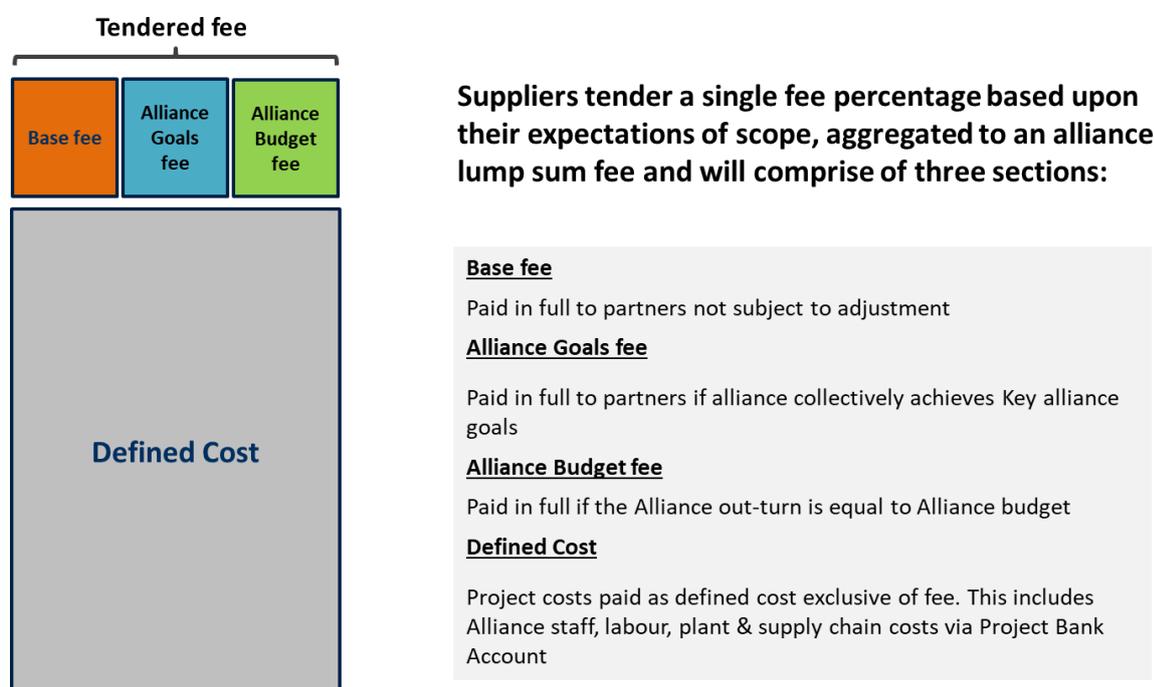


Figure 2 – How fee is recovered

### **Base proportion:**

This element of the fee will be paid to Alliance partners regardless of performance. It is intended to support a proportion of a partner’s corporate overhead contribution requirements, however will be set at a level such that the goals proportion of fee and budget fee will be required in order to achieve satisfactory overhead and profit recovery to their business .

### **Goals proportion:**

This fee element will link reward to achieving Highways England key programme outcomes. It will be paid to partners on the basis that the Alliance collectively achieves performance targets aligned to the key programme outcomes. In the event that part or all of the goals fee element is not earned in the year due to underperformance against the targets, it will be made available for reinvestment by the Alliance in initiatives to address the areas of underperformance.

**Budget proportion:**

In the context of the programmatic approach and certainty relating to the pipeline of work, this fee element will incentivise the Alliance partners to invest in innovation and productivity to ensure delivery against the programme budget. The Alliance will secure payment of this fee proportion in full in the event that programme out-turn is equal to the post efficient Alliance budget. The budget fee element however cannot be earned from any savings achieved due to amounts being forfeited from the goals fee element.

All three proportions of the fee will be assessed and payable against earned value on a monthly basis. This will ensure regular payment of overhead contributions to the Alliance Partner’s businesses.

**Alliance Budget surplus/deficit**

The Alliance Partners are able to earn an additional return through a proportion of gain share against the Alliance budget, over and above the budget share, in circumstances of budget outperformance (underspend).

A liability cap to the Alliance Partners for overall budget performance (overspend) will be set at the same level as the budget fee proportion. The share of overspend and underspend against the Alliance budget between the Alliance Partners and Highways England will vary in defined ranges. These ranges and share distribution will be provided during the ITN procurement phase.

The figure below shows how elements of the fee are recovered and impacted in different cost out-turn scenarios against the Alliance budget:

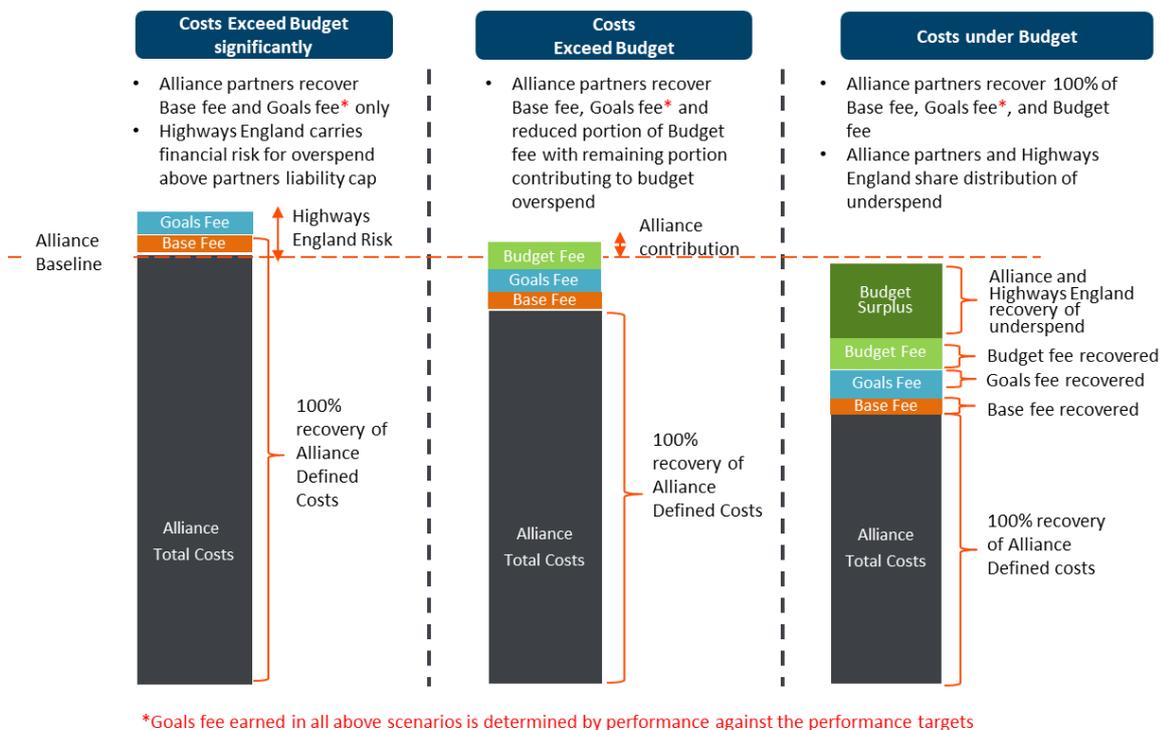


Figure 3 – Cost out-turn scenarios