



## **HIGHLANDS AND ISLANDS ENTERPRISE**

# **REPORT ON MAINTENANCE AND REPAIR MODELS AND PROCUREMENT OPTIONS FOR THE APPOINTMENT OF THE OPERATOR OF FACILITIES AT CAIRNGORM MOUNTAIN**

**21 February 2011  
Final V2**

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## REPORT ON MAINTENANCE AND REPAIR MODELS AND PROCUREMENT OPTIONS FOR THE APPOINTMENT OF THE OPERATOR OF FACILITIES AT CAIRNGORM MOUNTAIN

### 1 EXECUTIVE SUMMARY

- 1.1 The report provides details on the various maintenance and infrastructure options and procurement options in connection with the proposed procurement of an operator of the facilities at Cairngorm Mountain.
- 1.2 There are three principal options for maintenance and repair of the facilities at Cairngorm Mountain, including the funicular railway and the ski tows. One option is recommended - that the operator takes on responsibility for operating the facilities and maintaining and repairing the equipment (on the basis that Highlands and Islands Enterprise (HIE) retains ownership). The report also sets out a number of possible mechanisms as regards how the maintenance and repair costs might be funded.
- 1.3 The report also highlights some restrictions on the potential operator's scope for maximising financial returns from the operations, specifically, the ERDF Funding Agreement and Section 50 Agreement. These issues have been explored by [REDACTED], Regional Development Directorate, HIE with the Scottish Government and it would appear that these would be confined to the requirement to make available certain specified discounts for use of the funicular and to operate the funicular as a 'closed' system. There is a recommendation to explore whether there is a possibility and/or need to have these conditions relaxed or waived to improve the sustainability of the operations.
- 1.4 With a view to maximising interest in the role of operator, the report recommends that HIE engage in market sounding with the potential operators. The objective of this is to assist with the development of the specification and proposed procurement approach - to ensure that HIE's requirements are feasible and are better aligned with the market. It must be stressed that the principles of equal treatment, non-discrimination and transparency must be maintained during this process.
- 1.5 There is a considerable amount of information and documentation to be obtained and collated with a view to making it available to potential bidders, normally by means of a data room. The report summarises the information which would be required in the data room.
- 1.6 As regards procurement options, the report recommends that procuring the operator by means of offering a services concession contract has advantages over other options. A specification is similar to a services contract, but differs on the basis that the operator obtains its income primarily from exploiting the concession. There is also a need that a significant level of risk transfers to the operator. However, if during further development of the specification, HIE agrees to provide funding to the operator (whether capital or revenue), there will be a need to re-assess the procurement options to ensure that the procurement of the operator (with that funding) would still be regarded as a services concession.

### 2 BACKGROUND

- 2.1 We have been asked by HIE to provide details on the various maintenance and infrastructure options and procurement options in connection with HIE's intention to

offer the operation at Cairngorm Mountain to the market place and appoint a new Operator.

- 2.2 In order to assess the viability of the various options we required to become familiar with the limited information provided in relation to the existing Cairngorm Mountain Operation and what this covered.
- 2.3 In essence Cairngorm Mountain provides both Summer and Winter operations and includes the funicular railway and fixed ski tows across an area of approx 598 hectares. This includes the area for skiing and winter sports.
- 2.4 In terms of buildings and infrastructure these include a number of permanent buildings, incorporating the top Ptarmigan building, base station, day lodge, piste machine garage, mid station Shieling building and Coire na Ciste building to the lower part of the mountain. A further storage shed at the bottom of the ski road is leased from the Forestry Commission while a number of timber formed workshops and tow sheds are located within the ski area. In addition, the site includes the main access roads, footpaths, fences, car parks, sewage treatment works, ski tows, and the funicular railway.
- 2.5 The existing operation is currently run by Cairngorm Mountain Ltd (CML) which is owned by HIE, who operate the site under a lease and operating agreement which exists between HIE and CML.

### **3 MAINTENANCE AND INFRASTRUCTURE OPTIONS**

- 3.1 At present CML are responsible for maintaining the existing site including all parts of the infrastructure and buildings and in particular the main funicular railway and ski tows in accordance with the lease which exists between HIE and CML. It is apparent, however that CML have only been undertaking a basic maintenance regime over the last few years. This is as a direct result of a number of factors, the main ones being a lack of appropriate income over a number of years and the practice of the operator being to carry out maintenance on a piecemeal basis over a number of years.
- 3.2 During our condition survey inspections we have found that the funicular railway is being regularly maintained to a reasonable standard and that the tows are being maintained to a safe standard; however, the buildings and, more so, the ski tows and infrastructure, will require significant additional investment in the coming years.
- 3.3 It is therefore HIE's preference to tender the operation at Cairngorm Mountain which will ensure that the site is run more efficiently with a stringent maintenance regime in place ultimately reducing the current high level of liability and risks which lie with HIE.

#### **Options**

- 3.4 We have set out a number of options below in terms of the maintenance of the funicular and ski lifts and associated buildings, plant and machinery, roads, paths and the land generally. The options set out different approaches to assist with relieving HIE of the risks which currently exist, but recognising that risk cannot be eliminated entirely for so long as HIE remains the owner.
- 3.5 **Option 1 - the operator running Cairngorm Mountain as at present with the operator taking control of the maintenance and infrastructure**
  - 3.5.1 With this option the main risks associated with the maintenance aspect are largely taken away from HIE directly with the risks and liabilities being taken on by the operator. This would reduce the amount of funding HIE

has been providing in the past based on the new operator having a sound business plan.

3.5.2 A stringent operating agreement will be required, to incorporate a strict maintenance regime along with a monitoring process which will ensure each party undertakes their obligations to maintain the site including its infrastructure. As part of the agreement HIE could enforce the use of a sinking fund (see funding section below) by the new operator to cover the future anticipated maintenance costs for the ski tows and funicular therefore assisting financially should the income in any year put pressure on maintenance being cut back.

3.5.3 A series of control mechanisms would be required by HIE in this instance to ensure that the maintenance works are being undertaken as stipulated. There is also the question of enforcement if, for whatever reason, the operator is unable to undertake the routine maintenance. We would envisage some form of penalty whether monetary or otherwise (see funding section below) which could be invoked by HIE should such an event occur.

3.5.4 It may also be the case that an incentive may require to be offered as part of the tender to encourage any new operator to take on the total liability and risk.

### 3.6 **Option 2 - HIE taking on the full responsibility for maintenance and infrastructure with the new operator managing and running the site**

3.6.1 This would involve HIE taking on the existing maintenance team and full cost implications for maintenance and infrastructure along with all of the risks and liability that go with managing these. It would be possible for HIE to take on part of the overall responsibility (for example in relation to the funicular) with the balance being the responsibility of the operator under option 1.

3.6.2 As part of the operating agreement any prospective operator would request that a penalty provision is included should any parts of the infrastructure not be available for any length of time such as the funicular not operating due to maintenance / repair being required meaning a loss of income. The penalty is likely to take the form of a payment being made by HIE to the operator for any days lost at the Cairngorm Mountain over a set number of days.

3.6.3 Significant investment is now required in the ski tows and parts of the infrastructure and HIE would be responsible for this investment if this option were to be favoured. However in this instance HIE would be confident that Cairngorm Mountain was being correctly maintained therefore reducing the risk and liability going forward.

### 3.7 **Option 3**

3.7.1 Option 3 would allow for the maintenance and infrastructure to be passed to a third party who would become fully responsible for the maintenance and upkeep and would be directly accountable to both HIE and the operator. This would allow for all risks and liability to be placed on the third party while ensuring piece of mind in terms of a guarantee that the works and maintenance were being undertaken on a set basis.

3.7.2 The disadvantages would be that HIE would undoubtedly have to heavily incentivise this option in order to make it appealing to third party

companies to take on this level of liability. This is likely to be in the form of a services contract or some other payment being made to the third party. HIE will also incur costs in terms of the third party maintenance contract itself as well as in undertaking stringent checks to manage the third party.

### 3.8 Funding mechanisms

- 3.8.1 There are a wide range of funding models that could be used by HIE and the operator to pay the costs of maintenance and repair. Similar models could also be adapted to include the costs of a planned programme of works and other enhancements / investment by the operator.
- 3.8.2 We understand that there would be a need for an operator or HIE to carry out significant one-off works to the ski lifts at the outset to keep them operational in accordance with the relevant legislative requirements. Given the current economic climate and the financial performance of CML (excluding the last year), there is likely to be a question over the availability and cost of bank lending to the operator to fund this initial investment.
- 3.8.3 The Audit Scotland reports of 2009 and 2010 refer to a significant write-off being made by the Bank Of Scotland in connection with its loan to CML.
- 3.8.4 Unless the operator could fund the investment from its own resources, there may be difficulty in the operator obtaining bank funding to make that necessary investment without the possibility of some financial support from the public sector - at least until the operator can demonstrate the financial viability and sustainability of its business plan.
- 3.8.5 The proposed model would also depend on whether the operator would be making a significant investment (in terms of enhancements) in new plant and equipment.
- 3.8.6 Some possible models are as follows:

#### *HIE funds*

- 3.8.6.1 HIE funds all of the costs of maintenance and repair and either recovers the cost directly from the operator or through a higher rent (although the level of the rent need not be tied to the cost of the maintenance and repairs).
- 3.8.6.2 This model places considerable risk on HIE. Any increase in the costs of maintenance and repair would fall on HIE in the first instance and may leave HIE without reimbursement if the operator had insufficient funds. If the rent was fixed in the basis of anticipated repair costs, HIE would, additionally, bear the risk of the cost of unexpected repairs.

#### *Operator funds*

- 3.8.6.3 The operator could be required to pay all maintenance and repair costs directly irrespective of its income. Compliance would be subject to monitoring by HIE and failure of the operator could be subject to penalties (whether financial or otherwise).
- 3.8.6.4 The difficulty with this model is that it ignores the financial performance of CML and the fluctuating income due to the variable snow and weather conditions.

- 3.8.6.5 If the operator developed a business generating a profit every year, then this model would be viable, penalties would be real and enforceable and the operator would likely be in a position to borrow to fund maintenance and repair costs in the leaner years. If bank funding was not available to the operator, HIE may wish to consider offering a facility to the operator at commercial rates, to assist it during those leaner years.
- 3.8.6.6 However, if the reason that the operator has not carried out certain maintenance and repair requirements is that it does not have the funds to do so, HIE may have to decide whether to make the operator's financial position worse by enforcing a penalty, or considering termination of the operator's appointment and conducting another procurement process to appoint a new operator - with the significant cost and resource implications entailed. While it is possible to provide for indemnities in the contract for these matters, they are only of value to HIE to the extent that the operator has funds or some form of bond/guarantee to meet them. Consequently, the value of penalties as a remedy, where failure to meet the maintenance and repair requirements is as a result of lack of funds, is limited.

#### *Gainshare models*

- 3.8.6.7 An alternative would be to establish a model where the operator takes responsibility for the maintenance and repair of the plant and equipment, but HIE provides an ongoing commitment to the operator to support these costs.
- 3.8.6.8 There are a considerable number of variants to what is set out below which can have a considerable impact on the allocation of risk. We would recommend that any model is considered by your financial advisers before being included in the tender process.
- 3.8.6.9 One possible model would be to calculate the anticipated maintenance and repair costs over a specified period, such as the duration of the lease and to derive an assumed annual cost.
- 3.8.6.10 That assumed cost together with a pre-agreed amount for other costs (including labour) could be deducted from the actual turnover to derive a notional profit. The first, say, 20% of that notional profit could be retained by the operator and thereafter the profit be shared 50:50 with HIE.
- 3.8.6.11 A sinking fund could be established (to which the operator would contribute when turnover exceed a trigger point; and call upon when turnover fell below a separate level).
- 3.8.6.12 Under this model, the risk of the costs of maintenance and repair would be with the operator as the actual costs of maintenance and repair are not used in the formula.
- 3.8.6.13 The setting of the assumed cost is key. Too high and the operator will make excessive profit. Too low, and the operator will be disincentivised and will either seek to renegotiate or to exit.
- 3.8.6.14 The model could include penalties if the operator did not comply with its maintenance and repair obligations. For example, the share of the notional profit allocated solely to the operator could

be reduced to say, 15%. However, if the notional profits were lower than this, then the penalty would have no effect.

3.8.6.15 As stated above, there are a large number of variants. It would, for example, be possible to incorporate an annual payment by HIE to the operator towards the maintenance and repair costs. As part of the gainshare mechanism, that cost could reduce by, say 50% of the amount that turnover exceeds a specified threshold. In that model, the operator is still incentivised to increase profitability, but the public contribution is decreased to reflect the improved turnover.

3.8.6.16 The HIE contribution need not be tied to turnover, but could instead be tied to the costs of maintenance and repair. Under this variant, HIE would contribute a specified percentage of the maintenance and repair costs irrespective of the turnover. The liability of HIE could be capped in each year. This commitment to expenditure could be complemented by a profit sharing mechanism in the event of turnover exceeding a particular threshold.

3.8.6.17 Another possibility to cover fluctuating income and to recognise the possible difficulties of the operator in obtaining bank funding, would be for HIE to make available to the operator a loan facility (at a state aid compliant level of interest) to cover annual fluctuations in turnover. It is recognised, however, that making available such a facility would place a significant administrative and audit burden on HIE. On a similar basis to the sinking fund, the operator would draw on the loan either when the maintenance and repair costs exceed a threshold (or turnover fell below a specified level) and would be repayable in years when turnover exceed the higher trigger point.

### 3.9 Other Considerations

3.9.1 There are other considerations which need to be taken into account. In particular, significant investment is required in the infrastructure at Cairngorm Mountain including works to the private hill road leading from the Day Lodge to the Top Station (Ptarmigan building) and the replacement of some of the tows. A new operator is unlikely to wish to take on this expenditure without some form of incentive from HIE.

3.9.2 Consideration could also be given to HIE being responsible for the funicular, which would ensure that the main asset is controlled by HIE directly and that the maintenance was regularly carried out.

3.9.3 We have also noted that any new operator requires to be approved by the parties named in the Section 50 Agreement being the Local Authority and Scottish Natural Heritage. HIE would wish to ensure that the Local Authority and Scottish Natural Heritage agree the criteria prior to commencement of the procurement process to avoid the risk of having to make changes to the specification during the procurement process. This may restrict the number of operators available to tender.

### 3.10 Recommendations:

3.10.1 Fundamentally the main objective in tendering for a new operator is to mitigate (as far as possible in so far as HIE remains the owner of the land and assets) the liabilities and risks associated with Cairngorm Mountain

from HIE in the medium term. With this in mind it is our recommendation that the operation is offered in line with option 1; however, a number of stringent mechanisms will need to be incorporated at both tender stage and in the Operating Agreement to ensure that the site is maintained to the standards expected.

- 3.10.2 In addition investment will be required in the tows and infrastructure to bring them up to a satisfactory standard which will allow consistent and more cost effective maintenance. This investment will need to be evaluated as part of the pretender process and consideration given to whether HIE will incur this cost therefore making the operation more attractive or whether the new operator will incur these costs with them being considered as part of the tender process.
- 3.10.3 As regards funding models, we would recommend the use of a model which aligns the interests of HIE and the Operator as far as possible. Although HIE will remain the owner of the assets, it is in the interests of the operator to ensure that the plant and machinery are operating safely to maximise income. Similarly, it should be possible to develop a model which encourages the operator to invest in growing the business to generate more income - which in turn can be shared with HIE and ensure that there is an adequate proportion of that income allocated to maintenance and repair costs. We would emphasise, however, that there is a need for financial evaluation of the models before commencement of the procurement process.

## **4 DEVELOPMENT OF THE SPECIFICATION**

- 4.1 We have been asked to give consideration to how HIE would develop a robust and detailed specification of requirements at the next stage of the process leading to the procurement of a new operator of the site and facilities and the other steps it would need to take prior to the commencement of the formal competitive procurement process. We have been advised that liaison with CML for the purposes of this report would be inappropriate and, consequently, HIE has agreed that the development of the specification to be incorporated within the procurement documentation will be carried out at a later stage.

### **4.2 Pre-tender stage - engagement with potential operators**

- 4.2.1 As stated in paragraph 3.10.2 above, there are important steps that should be taken in the pre-tender stage (prior to the publishing of an advert or OJEU contract notice seeking expressions of interest). Indeed the Treasury Review of the Competitive Dialogue process (November 2010) highlights that this stage of the process is often the most neglected, but, if properly executed, would significantly improve the ability of contracting authorities to deliver an efficient and effective process.
- 4.2.2 This pre-tender stage would typically involve identifying potential operators and assessing their reaction (collectively) to a proposed requirement and procurement approach. This would have the benefit of bringing the perspective of the potential operators to HIE at an early stage in the process which will enable the competitive procurement process to be more focussed and efficient. It would also minimise the risk of going to the market with an untested specification where there is no interest, or where interest falls away during the tender process.
- 4.2.3 It is important to stress that market sounding focuses on potential operators as a whole rather than looking at the merits of individual companies. There must be no element of supplier selection or bid

evaluation during the process and it must be clear that there is no commitment from HIE or the potential operators.

- 4.2.4 The procurement regulations do not apply to the pre-tender stage, so there is no formal process to be followed. It would, however, be important to observe the general principles of equal treatment, non-discrimination and transparency - in basic terms, avoiding giving any one potential operator an advantage over another. To this end, there would be a need to record in writing the steps taken and the discussions which had taken place - to demonstrate compliance with these principles.
- 4.2.5 The objectives of the pre-tender stage include assessing the feasibility of what is being proposed. For example, the reaction of the potential operators to a requirement to bring the existing tows up to a required standard, both without and with any initial HIE capital investment. It may also include their reaction to possible financial models.
- 4.2.6 The pre-tender process might also indicate the number of potential operators that may bid for the contract - whether there are enough interested potential operators for a competitive process.
- 4.2.7 The information derived by HIE from this stage can then be used to further develop and refine the specification of requirements with the knowledge that HIE will be going to the market with requirements that are much more aligned with the market.
- 4.2.8 Government advice recommends that the pre-tender stage should not be carried out solely by technical and procurement personnel, but should involve those at the top level of an organisation to provide a broad business focus and to explore the overall purpose and the desired outcome.
- 4.2.9 We recognise that there is a sensitivity regarding the employees of CML and concerns which they may have regarding their continued employment. However, we are of the view that there is a need to conduct market sounding for the purposes of developing the specification and there will, undoubtedly, be a need to alert CML to what is proposed.
- 4.2.10 If the management team of CML did express an interest in bidding for the contract to act as operator (even informally) then HIE would need to be extremely cautious to avoid any claims of discrimination or unfair treatment in relation to their dealings with the current CML staff. This may involve including those current CML staff (who have expressed an interest in bidding) in the market sounding exercise.

#### **4.3 Assess the investment requirements for the ski tows**

- 4.3.1 For the purposes of awarding a contract for the operation of the facilities, there is a need to establish what is needed, by way of investment, to bring the ski tows to an standard which will allow consistent and more cost effective maintenance over the duration of the operating period - whereby the operator will be content to take over responsibility for health and safety issues and maintenance, repair and insurance requirements.
- 4.3.2 HIE has indicated that, in parallel with informal market testing / sounding, it would assess what budget capacity was available and offer this capital investment as part of the package - on the assumption that pre-tender discussions did not indicate that this was not required.

- 4.3.3 If HIE were prepared to accept a proposal whereby the appointed operator proposed a rationalisation of the ski tows, HIE would need to:
- 4.3.3.1 ensure that the specification was flexible enough to accommodate this;
  - 4.3.3.2 assess the impact that rationalisation of the ski-tows would have on the feasibility / sustainability of the proposed operator's operating model;
  - 4.3.3.3 decide how it would evaluate a bid with rationalised ski tows as against one that proposed to keep all ski tows open - with due account being taken of the impact on sustainability of the business model.
- 4.3.4 It should be noted that if HIE did include a financial contribution towards the capital requirements of the operator, there would be a need to assess whether this requirement affected the nature of the procurement (for example a contract for supply and installation of new ski tow equipment rather than a services concession).

#### 4.4 Identify activities where the interests of HIE and the operator are aligned

- 4.4.1 If HIE proceeds on the basis of the concession procurement model (see section 5 for further information on the procurement options) whereby the primary source of revenue of the operator is that derived from sales to the public, then the interests of HIE and the operator will likely be aligned in relation to activities that are profitable for the operator. Put simply, the operator will be incentivised to carry out these activities itself to maximise revenue and profit without the need for detailed service levels being specified by HIE. This market incentivisation may, however, need to be supplemented by specific obligations where these are relevant to HIE's wider policy objectives for the mountain and its contribution to local tourism businesses and other elements within the local economy.
- 4.4.2 Conversely, in relation to the less profitable aspects of the operations (including specific operating hours at times of low demand), or those which are not pertinent to the core operations, HIE will wish to determine a base level specification which all bidders will require to agree to, but to which they might propose enhancements.
- 4.4.3 We have discussed the maintenance and repair requirements of the funicular and the ski tows above. Another example might be maintenance of the paths - HIE would want to set a standard to which the paths would be maintained and transfer the responsibility for health and safety issues to the operator. There may also be a requirement for the operator to repair paths to that specified standard within a required timeframe (to avoid the operator simply closing unsafe paths for prolonged periods). These obligations would require to be backed up by monitoring and enforcement action - as with the maintenance of the ski tows.
- 4.4.4 Other examples include the picking up of litter and the Ranger Service - although we acknowledge that it is planned that the Ranger Service will be the subject of a services contract on the basis that it covers both the ski area (598ha) and the adjacent non-ski area on Cairngorm Mountain owned by HIE (820ha) for which the operator is paid by HIE.
- 4.4.5 While HIE has stated its view that the hours of operation of the funicular would be a matter for commercial judgement by the successful operator,

we would anticipate that HIE may have objectives to ensure that the funicular operates outwith the ski season (including any periods where it may not be profitable to do so). As an example, HIE may wish to specify a requirement that the operator keeps the facilities open throughout the year (specific holidays excepted), for specified times and runs the funicular a certain minimum number of times per hour/day. Of course, imposing requirements on the operator which are not profitable for the operator will increase its costs which may, ultimately, be passed on to HIE. It would be important, therefore, to ensure that there is full clarity within HIE as to the policy objectives - and the extent to which there can be a level of trade-off if required to create a viable business model.

#### **4.5 Prepare the data room information**

4.5.1 Potential operators are being asked to take on responsibility (and associated liabilities) for operating the facilities at Cairngorm Mountain which will involve the transfer to the new operator of the existing staff of CML. As this is an existing business and as the operator will be asked to take over operations without any ongoing revenue subsidy (recognising that there may be a HIE contribution towards maintenance and repair requirements), potential operators will need full information on the existing business of CML to enable them to develop their business plan in full light of the factual position. This must include any restrictions which will be imposed on the operator (whether through planning or other documentation), and any other ongoing issues that may affect financial performance or their ability to respond to future market changes - to ensure that they can develop a robust and detailed business plan.

4.5.2 For this purpose, we have listed below the key non-financial issues to which any new operator would require to give consideration, to assist it in assessing the attractiveness of the business or its need for investment and/or ongoing public sector financial support. It should be noted that this report does not address the financial issues that will need to be addressed in the development or evaluation of a business plan with a new operator.

#### **4.6 Operations**

4.6.1 Our understanding is that all operations currently undertaken by CML will be transferred to the new operator on the basis that option 1 (in section 3.5 above) will be followed. In addition to managing and operating the ski area (including the funicular railway) and associated buildings and car parks, we understand that this includes operating the Ranger Service. HIE may wish to assess which of the various operations undertaken by CML are loss making and which, if any, could be dispensed with, or removed from the operations to be transferred to the new operator.

4.6.2 While ultimately the assessment of what is/ what is not profitable is a matter for bidders to assess in developing their tender submissions, there is a need for HIE to determine a baseline specification. The reference to profitable / non-profitable activities is, as mentioned above, a useful focus on the basis that any commercial operator may seek to minimise costs and cut unprofitable activities. The baseline specification should seek to set out what would be the minimum acceptable to HIE.

4.6.3 Additionally, where HIE would not be prepared to accept a particular activity (such as mountain biking) proposed by a potential operator for the purposes of making the overall operations sustainable, HIE would need to specify the parameters of that restriction.

- 4.6.4 We note that it is intended that the Ranger Service will be a service which is required by HIE and which will be paid for by HIE. HIE would want to assess whether the inclusion of that contract (which would on its own be a contract for services) within the overall contract for operation of the facilities, would affect the categorisation of the overall contract as a concession. If the value of that services contract is above the OJEU threshold, consideration should be given to treating it separately from the main contract (if possible).
- 4.6.5 Our recommendation would be to carry out this assessment with a view to making the opportunity to be the new operator as financially attractive as possible - and to do so prior to offering the opportunity to the market; that should mean that there will be a number of attractive bids which HIE can then evaluate. While it might be possible to make changes to the required scope of operations for a particular bidder during the bidding process (depending on the terms of the contract notice or advertisement) as part of a variant bid, this can lead to difficulties in assessing competing bids.

## 4.7 **Contracts**

### *ERDF funding*

- 4.7.1 We are aware that there are continuing obligations associated with the ERDF funding provided in relation to the construction of the funicular railway. Annex A of the ERDF Approval Document is appended to the current lease between HIE and CML.
- 4.7.2 There are a number of restrictions in this document:
- 4.7.2.1 For a period of 25 years from the commencement of operations of the funicular, the funicular must only be used for purposes in line with those specified in the original ERDF application. It states that the present status of the project will not be changed during this period of time even if there is a change of ownership, and HIE is committed to ensure the dedication of the project to its approved purpose over 25 years. On the basis of the consultation between [REDACTED] and the Scottish Government referred to in paragraph 1.3, we understand:
- (a) that provided the funicular operates in some form for the bulk of the year, then HIE would not be in danger of breaching this condition;
  - (b) if HIE pursues the original objectives (i.e. winter skiing and other tourist activities at other times) in procuring an operator, and if the result of a competitive tender for an operator results in modifications to the use in order to permit viable operation, then the Scottish Government would be likely to interpret this as pursuing the original approved purpose.
- 4.7.2.2 Any profit from the project is to be re-invested in the uplift operation and in the environmental improvement of the area through the creation of an environmental fund. It further states that there is no possibility of revenue leakage; no dividends are to be distributed by CML, except to HIE (and even then, restricted to the coupon on redeemable preference shares). We understand, on the basis of the consultation referred to above, that;

- (a) the 'profit' referred to in this clause is that in the overall 'project';
- (b) a reasonable or minimum profit for an operator established by competitive process would not require to be reinvested;
- (c) the trigger for re-investment would be when the revenues from day one exceed the full costs of the 'project';
- (d) there will be no need for re-investment until the combined income in rents, sale of ERDF funded assets, profits and charges levied on CML or future operators of the ERDF funded assets (which does not include the ski tows) has reached the value of the original investment to which the ERDF funds contributed plus any interest charges borne by HIE (at least £19m).

4.7.2.3 There is a jobs requirement specified, but it would appear that this was a time limited requirement for 5 years to be audited in 2002 and 2007.

4.7.2.4 There are a number of discounts on season tickets which are required to be provided. On the basis of the consultation referred to above, we understand that these would require to be made available by any new operator.

4.7.2.5 The funicular is to be permanently operated as a closed system. Changes to the Visitor Management Plan are to be directed towards greater protection for the sites classified or proposed under the Birds and Habitats directives. On the basis of the consultation referred to above, we understand that any relaxation of this requirement would likely be a breach of the ERDF conditions.

4.7.3 The document states that failure to comply may result in the claw-back of the entire ERDF grant of approx £2.7m. On the basis of the consultation referred to above, we understand that the amount of claw-back would recognise the operation of the funicular over the preceding 10 years and any claw-back would be restricted to fifteen twenty-fifths of the total amount of claw-back.

4.7.4 The ERDF application defines the "Project" as follows:

4.7.4.1 "...to install a new visitor uplift facility on Cairngorm using a funicular railway system and to construct new terminal buildings to provide high quality visitor services".

4.7.5 While the definition of the 'Project' within the ERDF documentation would appear to be restricted to the funicular, proposed operators will want to be satisfied whether this provision imposes any undue constraints on them.

4.7.6 More concerning is the restriction on profits and payment of dividends. There are a number of aspects of this obligation that require to be clarified: firstly, the period of time it was intended to last for; secondly, whether it would apply only to the operation of the funicular and other parts of the 'Project' funded by the ERDF, or the whole of the operations of CML (while the definition of 'Project' within the ERDF application would suggest the former, the restriction on the distribution of profits (from all of CML's

operations) would suggest the latter); and whether it would also apply to a new operator

- 4.7.7 If they did, or could be regarded as applying to the new operator, then this would be a restriction which would significantly reduce the interest of bidders and the available procurement models, particularly as regards the private investment in infrastructure unless the European authorities agreed to vary or waive the conditions.
- 4.7.8 Prior to carrying out any procurement exercise, HIE would wish to establish the answers to these questions and, if they would restrict the new operator, to assess the possibility of the Scottish Government and the EU authorities varying or waiving these conditions given the change in the economic environment.
- 4.7.9 We have not been supplied with any other funding agreements that have continuing obligations, but this should be checked.
- 4.7.10 We have been advised that there are no hire purchase, equipment leases, maintenance agreements or supply agreements relating to equipment currently used by CML in carrying out the operations. There is reference in the accounts to an operating lease so this should be verified.

#### **4.8 Land and buildings**

- 4.8.1 We understand that HIE are intending to retain ownership of the land and buildings currently leased to CML and to lease them to the new operator.
- 4.8.2 We are of the view that HIE retaining ownership of the land and buildings is the appropriate course of action, at least until HIE is satisfied that any new operator has made the necessary changes to develop a sustainable business model and has made or is committed to making the necessary investment in the infrastructure. To transfer ownership over prior to this date could put at risk the land and the assets (including the funicular railway) in the event of insolvency of the operator.
- 4.8.3 Subject to the comments in section 4.7 above, there is a need under the ERDF conditions for HIE to ensure continued operation of the funicular for a period of 25 years after commencement of operations. Transfer of the land should only take place if HIE are satisfied that they would be in a position to take steps to enforce this obligation even though they had ceased to be the landowner.
- 4.8.4 The 2010 accounts state that CML has some "Freehold Property". It is assumed that this would be transferred to HIE and leased to the new operator with the remainder of the site. It should be established whether CML does, in fact, own land and, if so, this should be transferred to HIE to enable it to be let to the operator on the same basis as the remainder of the site.
- 4.8.5 The accounts also state that CML has leasehold property. It should be established that this is solely the land leased by HIE to CML and that there is no other landlord over part of the site which would be needed by a new operator. The leasehold property referred to in the accounts may be related to the Glenmore garage leased to CML by the Forestry Commission. The terms of the lease should be investigated to determine whether the lease can be assigned to the new operator.

- 4.8.6 Additionally, as stated above, there is a s50 Agreement which imposes a number of obligations on the operator, including the requirement to purchase a bond (to 'secure the obligations in the Agreement ' in the event of the funicular ceasing to operate) for £65,000 increased in line with the Retail Prices Index from the date of commencement of construction of the funicular project. The cost of this bond should be established and included within any financial appraisal of the operations. If HIE is willing to pay the costs of this bond (and we understand that this is the recommendation of the project team), then this must be included in the specification.
- 4.8.7 As regards the rent to be charged by HIE to the new operator, this could be established through a valuation or through the procurement process. We would recommend that HIE reviews the rent position in parallel with finalising the new lease provisions - to enable it to evaluate bids submitted and to either set a fixed rental payment, or at least to be aware of any subsidy contained in the level of rent set or proposed by a bidder. However, the value of the lease would largely be determined by the appetite of potential operators to take a tenancy - hence the likely profitability of the operation is key.
- 4.8.8 In relation to the duration of the lease, we would suggest that the length would depend on the required commitment from the operator to invest in the operations.
- 4.8.9 If the operator was not required to make any investment, but was simply to carry out the maintenance and repair to the equipment needed to keep it in a safe operating condition (assuming that this is feasible), then the duration of the lease could be kept reasonably short, for example, between five and ten years. Given the fluctuation in the snow cover, a lease of shorter duration will carry higher risk, whereas with a longer duration, there is an expectation that the general pattern will even itself out over the duration.
- 4.8.10 If the operator is required to make a significant investment, then the operator would likely require a longer duration (for example, 20-25 years) to enable it to repay any borrowings made to fund the investment and to make a sufficient return from its investment. It would be possible to incorporate various break options which could be exercised by HIE (either at its discretion or in specified circumstances).

#### 4.9 **Assets (excluding land and buildings)**

- 4.9.1 The accounts of CML state that there is a significant amount (in terms of value) of plant and machinery owned by CML., albeit - judging from the depreciation charges applied to date - this may be some years old. This may comprise piste grooming machines (x4), snow ploughs (x2), miscellaneous other vehicles and mobile plant.
- 4.9.2 There are two options for treating this plant and machinery. Firstly, transfer ownership to HIE and then include it as part of the lease - with an obligation on the operator to maintain and replace the equipment, which would still be in HIE's ownership.
- 4.9.3 The second option would be to transfer it into the ownership of the new operator in return for payment of the value of the equipment.
- 4.9.4 The initial advantage of the second option over the first is that it generates a receipt for HIE. The corresponding disadvantage is, of course, that the need for the payment is an additional financial hurdle for the new operator.

Alternatively it could be structured as a loan payable over the remaining useful life of the equipment.

- 4.9.5 Transfer of ownership also presents some additional difficulties in the event of re-procurement for another operator. That bid may need to take place on the basis that the new operator would have to reach a deal with the incumbent on purchasing plant and equipment, or may have to purchase equipment on the market at the outset. There can, of course, be provisions covering the purchase back of plant sold by HIE at the outset, but this would not necessarily cover any new plant and equipment purchased by the operator and in any event would be vulnerable in the event of the operator becoming insolvent.
- 4.9.6 Given the historical financial performance of CML, it would seem to be preferable for HIE to retain ownership of the assets and equipment to ensure that HIE has the ready ability to appoint an alternative operator, and to provide them with the equipment needed to commence operations swiftly, should the appointed operator not be successful in developing a sustainable operation. Once the operator had demonstrated the viability and sustainability of its business plan, then this could be re-assessed.
- 4.9.7 The position may be different based on financial advice, for example, if the operator was making a significant financial investment in plant and equipment and there was a need for it to be shown on its balance sheet for funding purposes.

#### **4.10 Licences**

- 4.10.1 There will be a need to detail the licences (such as alcohol licences, public entertainment licences, SEPA licences and licences for chemical storage, if appropriate) currently held by CML and to include a requirement for the new operator to obtain such licences by the date of commencement of the operations.
- 4.10.2 From our discussions, we do not envisage any significant obstacles here.

#### **4.11 Insurances**

- 4.11.1 HIE will want to ensure that the new operator has appropriate types and minimum levels of insurance cover, particularly public liability insurance and that the operator maintains that level of cover.
- 4.11.2 We understand that currently HIE insures HIE-owned assets and recovers the premiums from CML. If HIE intends this arrangement to continue with any new operator, then this information (the cover provided and the costs of the premiums to be reimbursed) should be included in the data room.
- 4.11.3 As the landowner, circumstances could arise where HIE finds itself responsible on the basis that it had not taken adequate steps to ensure that its operator had the necessary insurance cover in force and potentially brought in as an additional defendant to court action.

#### **4.12 Employees**

- 4.12.1 We have not been provided with details of the employees, but are aware of the number of employees of CML as set out in the accounts. It would be important to establish the identity of employees who would transfer under the Transfer of Undertakings (Protection of Employment) Regulations 2006

(“TUPE”) to the new operator. For example, it is possible for casual workers to be regarded as employees for the purposes of TUPE.

### *TUPE*

- 4.12.2 The award of a contract/concession to the new operator will involve the transfer of CML’s employees to the new operator. Such a transfer would fall within the scope of TUPE. The application of TUPE gives rise to certain important legal obligations.

### *The effect of TUPE*

- 4.12.3 The effect of TUPE is to protect employees who are involved in business transfers over which they have no control, but which result in a change in the identity of their employer. That protection is achieved by, amongst other things:-

- ensuring that the contracts of employment and conditions of employment of the relevant employees will transfer automatically, along with any other employment liabilities at the date of transfer;
- protecting employees from dismissal for reasons relating to the transfer;
- prohibiting contracting-out of TUPE; and
- making provisions for employees to be informed and consulted about the transfer and its consequences.

### *Which employees will transfer under TUPE?*

- 4.12.4 All employees assigned to the “undertaking” being transferred will transfer to the employment of the new operator.

- 4.12.5 It is important to note that, if there are employees who are partially engaged in the services being transferred and partially engaged in duties unrelated to the services being transferred (for example, if HIE were to take over maintenance of the funicular under option 2, staff engaged in maintenance of the funicular), there may be a dispute as to whether or not such employees are assigned to the undertaking being transferred and should therefore transfer. A series of tests has been developed to assist in deciding whether employees are assigned to an undertaking or part of an undertaking that transfers. These tests include looking at:-

- the amount of time spent on one part of the organisation or another;
- the amount of value given to each part by the employee;
- the terms of the employee’s contract of employment; and
- how the costs to the employer of the employee’s services have been allocated between the different parts of the employer’s organisation.

### *Obligation to inform and consult*

- 4.12.6 As mentioned above, TUPE imposes a duty to inform and consult with the relevant employees in relation to the transfer. TUPE obliges the outgoing employer (i.e. CML) to engage in an informing and consulting process with those members of staff (or more particularly, representatives, whether union or otherwise, of those staff) who will be affected by the transfer.

- 4.12.7 CML will require to inform and consult with the appropriate representatives or employees who are affected by the transfer about:-
- the fact that the transfer is to take place;
  - approximately when it is to take place;
  - the reasons for the transfer;
  - the legal, economic and social implications of the transfer for the affected employees. This, in essence, means:-
    - legal implications - the impact of the transfer on the employees' contractual statutory rights against their employer (temporary conditions of employment, continuity of employment etc.);
    - economic implications - pay and prospects; and
    - social implications - mainly social security implications such as pensions, national insurance etc.
  - any measures the employer envisages it will take in relation to the transfer of those employees (or if no measures are envisaged, this should be stated); and
  - any measures which the transferee (i.e. CML or its subsidiary) envisages it will take, in connection with the transfer, in relation to such of those employees, who by virtue of TUPE, become employees of the new operator after the transfer (or if it envisages that no measures will be taken, this should be stated).
- 4.12.8 "Measures" is a wide term and can catch any action, step or arrangement, eg. any material change to existing work and practices or working conditions and if redundancies are likely.
- 4.12.9 There is no specified time limit for the informing and consulting procedure, but it must be carried out long enough before the transfer to enable consultation to take place.
- 4.12.10 The incoming employer will be obliged to feed in to CML's informing and consulting process. Under normal circumstances, this means that the new operator must provide CML with information about any "measures" such as those mentioned above, which it proposes to take following the transfer. The intention is that CML should be sufficiently informed to enable it to consult with the relevant employees about those "measures". Legally, both CML and the new operator would be jointly and severally liable if the outgoing employer fails to comply with its obligations under TUPE. It is standard practice for the incoming employer to seek an indemnity from the outgoing employer as regards any liability for failure to inform or consult under TUPE.
- 4.12.11 There is also an obligation to exchange certain information between the old and new employer two weeks in advance of the transfer date.
- 4.12.12 Dismissal of employees in contemplation of a transfer is automatically unfair and would give rise to a claim for unfair dismissal by any employees affected.
- 4.12.13 While HIE may wish to leave any restructuring of the operations to the new operator, it would, if the operator was proposing redundancies at the outset, find itself involved in discussions with the unions and other employee representatives as part of the TUPE consultation process.

#### **4.13 Pensions**

- 4.13.1 We understand that a small number of employees are members of a defined benefit pension scheme, while the remaining employees are members, or are eligible for membership, of a stakeholder scheme.
- 4.13.2 The TUPE regulations referred to above also require that transferring employees who are members of an employer's occupational pension scheme are provided with equivalent benefits, but subject to a cap. This cap means that there would, for example, be no need for the new operator to offer a final salary pension scheme to those who are presently members of CML's scheme. They would be required to provide a pension, but this could be a money- purchase scheme where the new operator was obliged to make a maximum contribution of 6% of the employees salary.
- 4.13.3 Losing the benefits of a final salary pension scheme is, however, a significant loss for any employee and will likely be resisted by the employees affected and their representatives. The alternative would be to require the new operator to continue to provide the same benefits for the affected employees and to make the required payments into the fund - which will, of course, affect the viability of the operations.
- 4.13.4 According to the accounts of CML, the pension fund is in surplus based on FRS17. It should be noted that this is not necessarily the value that would be used when the pension is being transferred out.
- 4.13.5 Even where it is decided that no obligation will be placed on the new operator to offer a defined benefit pension scheme, there will still be a need for CML to instruct an actuary to establish the financial implications of ceasing to contribute to the pension scheme.
- 4.13.6 It should also be noted that a new auto-enrolment scheme will be coming into force in 2012 whereby employers will be required to offer personal pension accounts and employees will be automatically enrolled unless they opt out.

#### **4.14 Litigation and claims**

- 4.14.1 We are not aware of any ongoing litigation or claims that might affect the proposed appointment of a new operator. Obviously, that position may change.

#### **4.15 Health and Safety**

- 4.15.1 As part of the operating agreement, HIE would wish to transfer responsibility for health and safety issues to the new operator. However, for so long as HIE remains owner of the land and equipment, it retains a possible residual risk.
- 4.15.2 As part of the procurement process, HIE would be required to take all steps reasonably practicable to ensure the health and safety and welfare of those using the facilities.
- 4.15.3 This would include:
- 4.15.3.1 Ensuring that a proper contract is entered into detailing the duties and responsibilities of the operator with regard to health and safety;

4.15.3.2 Ensuring that the person undertaking the operations (and any works) is competent

4.15.3.3 Reviewing the operator's safety system

4.15.3.4 Taking steps to ensure compliance by the operator with its obligations.

4.15.4 While the Cableway Installations Regulations 2004 apply to installations installed or modified after 3 May 2004 (we understand that this would apply to the ski tows but not the funicular), it would be best practice to follow the procedures set out in the regulations for all of the installations.

4.15.5 As regards achieving the steps referred to in paragraph 4.15.2, this could be done by ensuring the involvement of a suitably skilled and experienced health and safety practitioner at appropriate stages during the procurement process - to set appropriate questions in the PQQ and review responses and policy documentation and to be satisfied that the proposed business plan, operating model and contract provisions meet the required standards.

4.15.6 During the operational phase of the contract, there will be a need for ongoing monitoring and enforcement in accordance with the terms of the contract. Again, there will be a need for a responsible person to be identified within HIE to ensure that this monitoring is carried out in accordance with the terms of the contract. Failure to do so could result in liability for HIE in the event of an incident.

## **5 PROCUREMENT OPTIONS**

5.1 The procurement options available to HIE will depend on the model selected, whether there will be a payment(s) made by HIE to the operator and the classification of the services and or works to be undertaken by the operator.

### **5.2 Classification**

5.2.1 The first option to assess is the nature of the activities to be undertaken by the operator in terms of the Common Procurement Vocabulary used in the procurement regulations.

5.2.2 There are a number of possible activities that will be undertaken by the operator. These include:

5.2.2.1 Operating the funicular railway- Part B service

5.2.2.2 Operating the other ski recreational facilities - Part B Service

5.2.2.3 Maintenance and repair of the equipment - Part A service

5.2.2.4 Maintenance and repair of buildings - works.

5.2.3 A further key consideration is whether there is going to be a payment by HIE to the operator. If there is no payment, then there is no public contract within the meaning of the procurement rules - instead there would be a concession.

- 5.2.4 It would still be possible for there to be a payment by HIE to the operator and for the proposed contract to be treated as a concession within the meaning of the procurement regulations.
- 5.2.5 A concession can be either a works or a services concession. These are defined as follows:
- ““public works concession contract” means a public works contract under which the consideration given by the contracting authority consists of or includes the grant of a right to exploit the work or works to be carried out under the contract;”
- ““services concession contract” means a public services contract under which the consideration given by the contracting authority consists of or includes the right to exploit the service or services to be provided under the contract;”.
- 5.2.6 If the operator was required to undertake significant works on the mountain as part of the tender process, then it may be that the contract could be regarded as a works concession. For the purposes of this report, it would appear more likely that the contract would be a services concession.
- 5.2.7 If there is a payment made by HIE to the operator, then an assessment needs to be undertaken of the level of risk transfer to the operator. If the agreement is structured such that the operator does not carry any of the risk of bad weather, increased maintenance and repair costs, then the contract would not be a concession. There is a need for a significant level of risk to transfer to the operator. It would be possible to structure the contract as a concession from a procurement law perspective, but the availability of this option will depend upon the financial modelling and structure of the proposed arrangements with the operator.
- 5.2.8 Assuming that the contract could not be classified as a concession, then it would be a public contract for services. As set out above, a number of the services are Part B services to which only a restricted part of the procurement regulations apply. An assessment would require to be undertaken to assess the relative values of each of the various services and the main object of the contract.
- 5.2.9 It would seem to us that the main object of the contract would not be the maintenance and repair obligations, but the operation of the facility (including the funicular). If this were the case, then, assuming that the contract was not a concession, that it could be structured as a Part B services contract.

### 5.3 **Advantages and disadvantages of each of the classifications**

- 5.3.1 If the contract were treated as a Part A services contract or a works contract with a value in excess of the threshold, then the procurement rules would apply in full requiring a full OJEU procurement.
- 5.3.2 If the contract were regarded as a Part B services contract, then a limited part of the regulations would apply - particularly the parts relating to technical specifications and filing of a contract award notice. The principles of equal treatment and transparency would also apply.
- 5.3.3 There is, therefore, no need for an OJEU contract notice to be filed for a Part B services contract, but this can be a useful means of advertising an opportunity widely.

- 5.3.4 Similarly, there is no need to follow any of the prescribed procedures set out in the regulations - although the principles do require some form of advertisement and process to enable bidders to express an interest and win the opportunity.
- 5.3.5 If the contract were regarded as a services concession, then the procurement regulations do not apply at all. The principles would, however, apply if the contract was of certain cross border interest. The safest course of action would be to assume that the operations would be of cross-border interest and to carry out some non-OJEU advertising (or possibly voluntary OJEU advertising) as with the Part B services.
- 5.3.6 As regards the difference between a services concession and Part B services, some parts of the regulations still apply to a Part B services contract. This would include the enforcement provisions if the value is above the threshold - namely that a disgruntled third party operator could bring proceedings against HIE under the process set out in the regulations. If the contract was a concession, then the appropriate procedure for challenging the award of the concession would be by judicial review - which can be a disincentive for would be challengers.
- 5.3.7 In any event (either a services concession or a Part B services contract), it would be open to a disgruntled person to make a complaint to the Commission regarding alleged non-compliance with the procurement rules.

## 5.4 Procedure to be followed

### 5.4.1 Open procedure

5.4.1.1 The open procedure is a single stage procedure where bidders are invited to bid against a specification set by the contracting authority. There is no scope for negotiation. This procedure is available for all OJEU procurements. The Public Contracts Scotland portal has a version for non-OJEU contracts.

5.4.1.2 We do not anticipate HIE being in a position to set a specification which will allow a bidder to respond without the need for dialogue or negotiation. Accordingly, this procedure would not seem to be suitable.

### 5.4.2 Restricted procedure

5.4.2.1 This is a 2-stage procedure where candidates typically submit a PQQ and at least 5 bidders are invited to submit a tender. On a similar basis to the open procedure, it would not seem an appropriate procedure due to the lack of scope for negotiation or dialogue with the bidders.

### 5.4.3 Competitive dialogue procedure

5.4.3.1 This procedure is available only for particularly complex contracts. While an eligibility assessment would need to be made once the specification had been finalised, it would seem reasonable to assume that this procedure would be available to HIE in the event that it was needed (i.e. if there was a need to follow a full OJEU procedure).

- 5.4.3.2 The procedure involves a selection procedure similar to that used in the restricted procedure. A minimum of three parties are then invited to participate in dialogue - to discuss all aspects of the contract and to agree all key contract terms with all bidders during the competitive phase.
- 5.4.3.3 Once HIE was satisfied that it had identified a solution capable of meeting its needs, it would close the dialogue and invite the submission of final tenders. The winner would be selected against the award criteria set out in the original invitation document issued to the three bidders.
- 5.4.3.4 The contract document agreed with the bidder during the dialogue would be fine tuned and clarified (as needed) and then signed (after the appropriate standstill period).
- 5.4.3.5 If the proposed contract with the operator was regarded as a public contract rather than a services concession, then this would appear to be the most appropriate procedure to follow.

#### 5.4.4 Negotiated procedure

- 5.4.4.1 This procedure is not readily available for the award of public contracts - it having effectively been replaced by the competitive dialogue procedure. It is available in a very limited set of circumstances.
- 5.4.4.2 Having said that, if the contract with the operator was regarded as a concession or Part B services contract, it would be possible to structure the procurement process along similar lines to the negotiated procedure - but recognising that the specific rules do not apply to services concessions and only to a limited extent to Part B services contracts.
- 5.4.4.3 The procedure could be structured with a similar PQQ process to narrow the field to focus the negotiating stage with those capable of meeting HIE's requirements
- 5.4.4.4 Thereafter, three of the candidates could be invited to negotiate. This could be structured on a similar basis to the competitive dialogue such that all aspects of the contract would be discussed and negotiated.
- 5.4.4.5 While HIE would want to ensure that heads of terms encapsulating all key points with the bidders were agreed prior to submission of best and final bids, there is no need to take the negotiation of the contract to the same stage as would typically happen in the context of a competitive dialogue.
- 5.4.4.6 The contract would require to be finalised after the award of the contract. This means that detailed contract negotiations only have to take place with one bidder rather than with all bidders and needs less resource from HIE.

## 5.5 Procurement procedure recommendation

- 5.5.1 Unless a specification can be developed that would permit use of the restricted procedure (which we do not consider likely), we would

recommend that the contract be structured as a services concession (and if that were not possible for the reasons set out above, as a Part B services contract) and (for either of those scenarios) that a procedure similar to the competitive negotiated procedure set out in the regulations be followed.

- 5.5.2 However, the final decision on the procedure to be followed cannot be taken until the completion of the pre-tender stage and, specifically, the outcome of the engagement with potential operators regarding the specification for the proposed operator.
- 5.5.3 We have been asked to comment on the risks for HIE should they commence a procedure as a services concession and if, during the process, it becomes apparent that the contract would not be considered a services concession.
- 5.5.4 As stated above, we are of the view that the pre-tender consultation will be invaluable in assisting HIE to develop the specification and achieve a greater understanding of what will be acceptable to operators and what will be required to deliver a sustainable operation.
- 5.5.5 If HIE makes its decision on the procedure to be followed on the basis of all of the information available to it and, it can justify its decision on the basis of that information, then it is highly unlikely that it would need to start a new process if it transpired that, through unforeseen circumstances, another procedure would have been more appropriate.
- 5.5.6 In any event, as stated above, it would appear that the second most likely procedure would be a Part B services contract which could largely follow the same procedure as the services concession.
- 5.5.7 Furthermore, HIE may wish to voluntarily advertise the in the OJEU which would also assist in reducing the risk of any challenge being made - on the basis that HIE had voluntarily complied with the advertising requirements of the other possible procurement procedures - albeit that it would have followed a different procurement process.
- 5.5.8 We have also been asked to highlight the key decisions that would affect the choice of procurement procedure available to HIE. These are as follows:
  - 5.5.8.1 whether there is any financial support payable by HIE to the successful operator. The likelihood of this would be determined by the pre-tender consultation and the financial modelling. If no support is required then the most likely procurement route is a services concession;
  - 5.5.8.2 if there is a likely requirement of funding payable by HIE, the amount of the funding and the impact of that funding on the level of risk assumed by the operator would need to be assessed - as stated above, there is a need for significant risk to transfer for there to be a services concession. If there was not a significant transfer of risk, then there would be a need to structure the contract as a services contract;
  - 5.5.8.3 there is a need to establish the 'main object' and relative values of each element of the contract - including the operation of the ski facilities, operation of the funicular, maintenance and repair of the equipment, maintenance and repair of the buildings - this would

principally be relevant if the contract was to be structured as a services contract rather than as a concession - this would determine whether the contract was a Part A or Part B services contract. As stated above, Part A services require a fully compliant OJEU tender (we would most likely follow the competitive dialogue procedure in that scenario). The issues below would have an impact on this assessment.

5.5.8.4 whether the operator is required to make a significant capital investment - if this was set out in the specification, then this may have an impact on the 'main object' of the contract and change the procurement procedure to be followed. For example, if the operator was required to carry out significant capital works, then an assessment would need to be made as regards:

- (a) whether the operator or HIE would fund the works - if HIE, then the contract may be treated as a works contract or possibly a supply contract (if the contract was treated as a contract for the purchase and installation of ski equipment) - either of these cases would require a fully compliant OJEU procurement most likely following the competitive dialogue procedure;
- (b) if the works were funded by the operator, then the contract may be treated as a works concession - which would require to follow the procedure set out in the procurement regulations;

5.5.8.5 whether there was a requirement for services to be provided for HIE as part of the main contract but which did not relate to the ski area - HIE would wish to ensure that there were no such services (particularly where the value of such services was in excess of the relevant procurement threshold) to avoid the risk of challenge to the whole procedure.

## 5.6 Resources from HIE

5.6.1 HIE would wish to ensure that it had the appropriate level of skill and expertise during the negotiation stage and in assessing bids. There would be a need for expertise in the industry and financial expertise, to assess the business plan, models and projections, etc.

5.6.2 Running such a procurement process will require a considerable resource requirement from HIE, and it would want to ensure that the persons involved had the capacity to devote the necessary time to the process.

5.6.3 It is difficult to predict the extent of the resource that will be required as this will be affected by a number of factors, including the extent and success of pre-tender engagement, the number of bidders invited to bid and the extent of the differences between each of the bids.

5.6.4 We can, however, set out the particular skills that would typically be required to attend bidder meetings:

- Project director
- Project manager (to support the project director)

- Procurement expert
- Financial adviser / modeller
- Technical adviser
- Legal adviser

There may be a need to call in other experts as required (for example, health and safety) and other technical experts with different specialist skills.

- 5.6.5 As regards the time input required, the greatest requirement is again during the negotiation / dialogue phase. Again, this will vary depending on the circumstances; however, the key persons listed above will likely require to spend between 75% and 100% of their time on the contract during this phase. Further information on the likely roles and tasks is set out in the annex.
- 5.6.6 It should also be noted that while some of these roles can be outsourced, our experience and Government guidance suggests that there is a need for a HIE decision maker to attend bidders' meetings to ensure that they are as effective and efficient as possible.
- 5.6.7 In addition to the resources for running the negotiation/dialogue, there is also a need for HIE to resource the on-going management of CML during this period. It is anticipated that at least one dedicated full-time person will be required for this purpose (Account Manager/Project Manager), supported by the Project Team.

## **6 PROCUREMENT PROCESS KEY DATES AND MILESTONES**

- 6.1 The table on the next page has been prepared on the basis of our experience of conducting complex competitive dialogue and negotiated procedure procurement processes.
- 6.2 There is a generous number of bilateral meetings provided for and there may be scope to reduce that number.
- 6.3 We would suggest that if the contract was restricted to an operating agreement that the procedure could be completed in less time than that indicated. However, this time would likely be needed if there is a requirement for significant investment and/ or if complex funding models are involved.

| <b>Pre-tender Phase</b>  | <b>Deadline</b> | <b>Commence in Week</b> |
|--|-----------------|-------------------------|
| Carry out assessment of viability of current operations of CML   | 29 April 2011   | 0                       |
| Seek agreement of Scottish Government to waive ERDF requirements relating to the funicular (if needed)   | 29 April 2011   | 0                       |
| Engage with Scottish Government sponsor department regarding proposed course of action   | 29 April 2011   | 0                       |
| Establish the availability of HIE funding for the new operator for ongoing maintenance and repair of facilities and equipment  | 29 April 2011   | 0                       |
| Decide whether to approach the planning authority to discuss amending the s50 requirements re the closed funicular system and use of parking charges (also, potentially requirement for a bond) - (do so if decision positive) | 29 April 2011   | 0                       |
| Open dialogue with local authority and Scottish National Heritage regarding consent re identity of operator under s50 Agreement - with a view to agreeing specification  | 31 May 2011     | 0                       |
| Develop basis on which to obtain market sounding (proposed requirement and procurement approach)   | 1 April 2011    | 0                       |
| Carry out market sounding with potential operators   | 29 April 2011   | 5                       |
| Obtain and collate information and materials for data room   | 30 April 2011   | 0                       |
| Draft OJEU contract notice (or non-OJEU equivalent) and PQQ  | 13 May 2011     | 9                       |
| Draft selection criteria (the basis on which candidates at PQQ will be assessed re proceeding to the negotiation stage)  | 13 May 2011     | 9                       |
| Develop financial modelling  | 27 May 2011     | 9                       |
| Draft Invitation to Negotiate / Invitation to Participate in Dialogue  | 27 May 2011     | 9                       |
| Develop heads of terms in relation to the contractual documentation (to be entered into by the successful operator)  | 27 May 2011     | 9                       |
| Draft award criteria (the criteria for evaluating the final bids submitted by tenderers)   | 27 May 2011     | 9                       |

|  |             |    |
|--|-------------|----|
| Decide on the maintenance and repair option to be included in requirements | 27 May 2011 | 9  |
| Re-assess and make final decision on procurement procedure to be used      | 27 May 2011 | 9  |
| Finalise specification of requirements and contract notice and PQQ         | 31 May 2011 | 13 |
| Obtain final internal approvals  | 3 June 2011 | 13 |

| <b>Selection Phase</b>  | <b>Deadline</b>  | <b>Process Week</b> |
|---|--|---------------------|
| Submit contract notice and issue PQQ to interested parties                          | 6 June 2011  | 0                   |
| Return of completed PQQs  | 8 July 2011  | 5                   |
| Evaluation of PQQs and issue notification to successful and unsuccessful candidates | 22 July 2011   | 7                   |
| <b>Negotiation Phase</b>  | <b>Deadline</b>  | <b>Process Week</b> |
| Issue of ITN/ITPD to shortlist  | 25 July 2011   | 8                   |
| Bilateral Meetings  | 19 August 2011   | 10                  |
| Bilateral Meetings  | 2 September 2011   | 12                  |
| Submission of Tender Negotiation / Dialogue Pack                                    | 9 September 2011   | 13                  |
| Bilateral Meetings  | 7 October 2011   | 15                  |
| Bilateral Meetings  | 21 October 2011  | 17                  |
| [Bilateral Meetings (if needed)]  | 4 November 2011  | 19                  |
| [Bilateral Meetings (if needed)]  | 18 November 2011   | 21                  |
| Close of Dialogue (Competitive dialogue only)                                       | 9 December 2011 [or, 4 weeks earlier if number of bilateral meetings reduced by 2] | 25 or [21]          |
| Issue of Invitation to Submit Final Tender  | 9 December 2011  | 25 or [21]          |
| Final Tenders Submitted   | 13 January 2012  | 29 or [25]          |
| Preferred Tenderer selection  | 10 February 2012   | 33 or [29]          |
| Finalisation of contract documentation  | 16 March 2012  | 37 or [33]          |
| Standstill (if needed)  | 29 March 2012  | 42 or [38]          |
| Execution of operating agreement and ancillary documentation                        | 30 March 2012  | 44 or [40]          |

## Annex - Anticipated key roles and skills

- Project director
  - responsible to senior responsible officer (SRO) and for keeping SRO briefed on the procurement process
  - leads the process
  - must have necessary technical, financial, legal and commercial awareness (supported by experts as required) to enable them to manage the project team, external advisers and run the negotiation / dialogue meetings
  - attends and runs negotiation / dialogue meetings
  - approves procurement documentation and decisions during the process
  - manages the assessment process
  - time requirements:
    - pre-tender stage - 20 to 25% assuming that the majority of the work is delegated
    - selection phase of procurement process - similar to that of typical procurement - assuming documentation approved in pre-tender stage, time commitment is likely to be in the region of 10% pending return of the PQQs. Time required for assessment of PQQs depends on the number received - assume 50-75% of time during the last two weeks of this stage.
    - negotiation phase - the time required will vary depending on the circumstances; however, the Project director will likely require to spend between 75% and 100% of their time on the project during this phase - primarily in preparing for, attending and reviewing information / responses received at and following negotiation / dialogue meetings.
- Project manager
  - provides support to the project director
  - can take primary role in development of the documentation
  - prepares documentation for negotiation/ dialogue meetings following outcome of previous meeting (on basis of instructions from Project director - to free up time of Project director to focus on meetings)
  - must have suitable awareness of the process and of the documentation required, drafting skills and awareness of the technical, financial, legal and commercial requirements
  - resource requirements - pre-tender stage 50 to 75% of time engaged on the Project; resource requirements at other stages will likely be similar to those of Project director
- Procurement expert
  - role sometimes combined with that of Project manager

- ensures that Project director and Project manager are aware of the procedural requirements
- ensures compliance with the procurement rules
- must have detailed knowledge of HIE's internal procurement procedures and EU procurement rules
- resource requirements depend on whether Project director and/or Project manager have sufficient knowledge of procurement requirements and whether attendance is required at all dialogue meetings. Assuming that attendance is required:
  - pre-tender stage - approx 50% of time (most likely less at the beginning of the phase and more at the end where the bulk of the drafting is required)
  - negotiation phase - similar to Project manager if attendance is required at meetings; 25% if attendance is not required
- Financial adviser / modeller
  - To provide expert financial advice:
    - re the existing operations of CML,
    - re the development of financial aspects of the pre-tender consultation with potential operators,
    - re the development of the financial aspects of the specification during the pre-tender stage,
    - re the assessment of the financial position of candidates submitting PQQs (if necessary),
    - at negotiation / dialogue meetings relating to the financial aspects / models
    - re assessment of the financial models proposed by bidders in final tenders

It is difficult to predict the resource requirements at each of the above stages. At the pre-tender stage, there is quite heavy involvement, which could involve approximately 25% of time; during the negotiation /dialogue phase, there is no need for the financial adviser to attend all meetings, but they should attend those which relate to the financial aspects / financial models. The number of meetings which they will require to attend will depend on the complexity of the financial arrangements. During these meetings, it is likely that they will spend between 75 to 100% of their time working on the Project. They may also be required to review the financial elements of legal documentation.

- Technical advisers
  - Each technical adviser's role will relate to:
    - the development of the specification - taking into account the feedback received from the pre-tender consultation with potential operators

- reviewing and assessing any technical aspects of bidders proposals
  - attending dialogue meetings to discuss technical aspects of a bidders proposal
  - formal assessment of the technical aspects of final tenders
  - technical advice required will include that relating to the maintenance and repair options for the funicular, ski tows, buildings and other elements of the ski area
  - there will also be a need for advice from an expert on the running of skiing operations to assist with developing the specifications, assessing the feedback received from the pre-tender consultation, to act as a sounding board re proposals from bidders and to test bidder's proposals to ensure that bids are realistic, workable and reflect market conditions.
  - other technical experts (for example, health and safety) may be required to look at specific aspects of the specification or a bidder's proposal
- Legal adviser
    - as with procurement expert, this role is sometimes combined with that of project manager
    - must have relevant legal skills and awareness of other issues (financial, technical) that will require to be captured in the legal documentation
    - ensures compliance with internal HIE requirements and legislation generally
    - assists in the development of the procurement documentation
    - primary responsibility for development of the heads of terms (with input from others) and contractual documentation
    - supports project director regarding negotiation of contractual conditions during negotiation / dialogue phase
    - attendance at meetings where relevant to legal aspects or drafting of contractual documentation
    - provides commercial advice to Project director on the acceptability of bidder's proposals re contractual documentation
    - Time requirements will depend on the split of role between procurement adviser and legal adviser re drafting of documentation. Assume approximately 25% during the pre-tender stage and 50 to 75% during the negotiation phase extending to 75 to 100% during the period for finalising the contractual documentation towards the period from the last bilateral meeting to the issue of the invitation to submit final tenders and also once the winning bidder has been selected to contract execution.