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16 February 2018

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**INDEPENDENT ASSURANCE REVIEW
HIGHWAYS ENGLAND - ROUTES TO MARKET PROGRAMME
DELIVERY INTEGRATION PARTNER - ITT STAGE – INITIAL REVIEW**

Introduction and Background

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General

7. The RtM programme is crucial to HE's successful performance and effective delivery during the remainder of RP1 and throughout RP2. RtM will support the Regional Investment Programme (RIP), which will see some £9 billion of investment over six years in capital and major operational renewal schemes across HE's six regions.
8. The RIP will be delivered by the Regional Delivery Partnership (RDP), the major element of which is the series of DIP frameworks which are the subject of this procurement. The DIPs will be awarded contracts under the various frameworks to deliver packages of schemes on a design and build basis.
9. The frameworks will last for 6 years¹; this is the period during which contracts may be awarded under the frameworks, but of course those contracts will extend for some years after the expiry of the frameworks.
10. The DIP procurement is being undertaken following the publication of a contract notice on 16 January 2018 and a corrigendum on 19 January. It comprises eight lots (ie eight individual frameworks): three of these will deliver smaller value packages up to £100 million each; and five are for larger packages above that amount. Each package will comprise several individual schemes.
11. The Panel found much to support in the ITT principles (and the preceding stages). In particular, we commend the following key aspects:
- clear evidence that significant attention has been paid to understanding and adopting recent good practice in the UK major programme sector²;
 - strong market engagement by way of a formal Market Engagement Day prior to designing the procurement process and post-design webinars to describe key features to the market; lessons have also been incorporated from regular feedback meetings with suppliers in the Collaborative Delivery Framework;

¹ Regulation 33 of the Public Contracts Regulations (2015) provides that the term of a framework shall not exceed 4 years, save in exceptional cases that are justified, in particular by the subject matter of the contract. HE has set out its justification transparently in the Contract Notice and the Panel agrees with HE's view that this issue represents a low risk of procurement challenge.

² For example:
Transforming Infrastructure Performance, Infrastructure Projects Authority, December 2017
From Transactions to Enterprises - a New Approach to Delivering High Performing Infrastructure, ICE Infrastructure Client Group, March 2017

- clear evidence of healthy market appetite, including from new players;
- the use of a design and build approach so that the knowledge and expertise of works contractors and their supply chain can influence the efficiency of scheme design and delivery.
- a programmatic approach with significant upfront commitment to provide DIPs with an incentive to invest in continuous improvement;
- a focus on the 'Golden Thread' – so that promises made and evaluated in tenders are contractualised and carried through to the secondary contracts;
- a recognition that the success of RtM will depend on a fair balance of risk and reward for the DIPs, rather than an emphasis on lowest cost which simply drives the wrong behaviours;
- novel commercial arrangements which give DIPs the opportunity for gain provided they deliver on HE's objectives and goals, notably an improvement in the Benefit to Cost (BCR) ratio at scheme and aggregate package level (although see the Panel's concerns about complexity in section 14);
- prevention of excessive windfall gains;
- the use of DIP performance metrics that are linked to the measures on which HE's performance is judged; and
- management information systems that use live data to feed into the performance management, incentivisation and contract allocation arrangements.

Observations and Recommendations

12. The Panel has the following observations and recommendations:

13. Overall Procurement Timescales

- 13.1 The Panel is clear that the procurement team is working hard and at pace to develop innovative and beneficial commercial and procurement strategies.
- 13.2 However, this is one of the most complex procurements that the Panel has reviewed - more complex in terms of lotting, incentivisation, performance management and contractual arrangements than HS2's Main Works Civils contracts, which are around the same overall value.
- 13.3 Against that background, the Panel has a major concern that insufficient time has been allocated to developing, finalising and assuring the ITT principles and processes and the associated contractual arrangements. Examples that have stimulated this concern include:
 - we were told that key aspects of the commercial evaluation methodology are still under discussion – ideally these should have been settled (and approved) much earlier in the process at procurement plan stage;

- the tight timescale for the Supplier Qualification (SQ) stage – applications are due back on 16 February, while the procurement timetable we were shown envisages these will be assessed and the outcomes notified in time for tenders to be invited by mid-March; this seems ambitious;
 - the LoD2 review has been scheduled to commence on 21 February and yet we were told that the Instructions for Tendering (IFT) and associated material is only at first draft stage – it is important that both the LoD2 review and the subsequent LoD3 assurance review by the Panel (currently scheduled for 5 March) is conducted on the near-final draft of the documentation; and
 - uncertainty as to whether the external legal adviser’s letter of assurance (which is a key input to the LoD3 assurance review) will be available for that review.
- 13.4 HE has emphasised that timely completion of the DIP procurement is crucial to the effective delivery of the RIP and will be a key driver in meeting HE’s challenging efficiency targets. The Panel fully appreciates this.
- 13.5 However, in order to mitigate the risk of a procurement legal challenge, it is vital to ensure that the ITT processes are properly thought through, and that the ITT documentation is of a very high standard. This is to ensure that the contracting authority upholds the underlying principles on which the Directive and Regulations are founded, namely: transparency; equal treatment; and proportionality.
- 13.6 We appreciate that HE has a good track record in avoiding procurement challenge, but the Panel believes there will be a higher risk for this procurement simply because so much is at stake, given that an unsuccessful bidder will be locked out of major workload for many years. [REDACTED]
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[REDACTED] Any time saved by short-cuts in the ITT development period will be significantly outweighed by time lost due to a procurement challenge (even if it is ultimately unsuccessful).
- 13.7 Taking all of this into account, the Panel strongly **recommends** that the procurement timescales are reviewed to balance the desire for early award of the DIP framework with more realistic timescales for the ITT processes, thus mitigating the risk of an undesirable and time-consuming legal challenge. In making this recommendation, the Panel wishes to re-state that this is not a reflection on the effort of the procurement team, but rather on the challenging, and perhaps over-ambitious, timescales.

14. Commercial Arrangements and Incentivisation

- 14.1 The Panel endorses the key aims of the incentivisation regime, which are to:
- recognise the supremacy of the scheme budget;
 - reward the achievement of common goals;

- allow the DIP to retain gains within the budget, provided the BCR is maintained or improved and other outcome targets are met;
 - avoid excessive windfall gains;
 - encourage a programme-level approach by aggregating reward and mitigating risks across packages of schemes; and
 - ensure that incentivisation is based on objective measures.
- 14.2 The Panel wishes to commend the quality and depth of thought applied to developing the commercial principles – it is clear that beneficial lessons have been learnt from the Collaborative Delivery Framework and recent industry good practice.
- 14.3 That said, the incentivisation arrangements are extremely complex – more than the Panel has previously encountered. Particular areas of complexity are apparent in:
- the pain / gain mechanism for the Option C contract, where the sharing arrangements are geared on a sliding scale depending on the percentage realised – the Panel normally advocates a simple 50:50 share³;
 - the complex interplay between the gainshare at target cost level, scheme budget level and package level; and
 - complexity in the timing of payment and claw-back arrangements where there are two issues: the fact that final gain cannot be calculated until after construction; and the issue that finalising package level gain will require all schemes in the package to be have progressed sufficiently.
- 14.4 The Panel always advocates that commercial arrangements are kept as simple as possible in order to ensure clear line of sight by all parties of the incentives that drive the desired behaviours, and to avoid unintended consequences and disputes that undermine collaborative relationships.
- 14.5 In the Panel's view, the commercial / incentivisation regime and its complexity raise several issues:
- The entire regime is rightly founded on the principle of the supremacy of the scheme budget and any gainshare depends on beating the budget. But this will only be attractive to bidders and, subsequently, DIPs if they have confidence that scheme budgets are set at a reasonable level, with a realistic prospect of beating them. Tenderers / DIPs will be aware that these are post-efficient budgets, which reflect the efficiency pressure imposed on HE. The Panel was told that this risk will be mitigated by ensuring transparency in the scheme budget make-up, using a bottom-up approach identifying works item costs from HE's comprehensive Project Controls Framework, risk pots and allocation for land etc. The Panel

³ although we realise that, in this case, the employer's gainshare arising from the Option C contract is ploughed back into higher level gainshare pots – that may explain the lower proportion for the DIP's gainshare at contract level, but not the complicated gearing.

welcomes this approach, but we also **recommend** that every effort is taken to ensure scheme budgets are struck at realistic levels to avoid undermining the undoubted benefits of the incentivisation regime.

- The complexity of the scheme may be off-putting to tenderers who may not fully understand it or see risks in achieving gain. This may impact on market appetite and the competitiveness of bids. The Panel **recommends** that this risk is mitigated by a clear description of the incentivisation regime in the IfT and in a tender briefing event early in the tender period.
- The complexity of the scheme may be difficult to capture with precision in the various contractual documents, which must avoid unintentional consequences or loopholes. The Panel is confident that HE's legal team and its external legal adviser will be up to this challenging task, but it cannot be rushed. The LoD2 page-turn review will provide confidence on this score.
- A major opportunity for the DIPs to win gainshare will be by maintaining or improving the BCR. We understand this will be baselined on a scheme basis at the end of stage 2 (option selection). It will be calculated for incentivisation purposes at the end of stage 4 (following preliminary design and statutory processes) and again at end of construction - the 'delivered BCR' - on which performance bonus will be calculated. Clearly tenderers will be interested in the timing of the various BCR calculations and the sequencing of when gain share will be paid and if there will be the risk of clawback (which is intensely disliked by contractors). The Panel also wonders if there is any opportunity for gaming the BCR to enhance gainshare, in terms of assumptions, say, about journey time savings or safety outcomes. Clearly any opportunity for gaming will cause friction between the DIP and the authority and undermine the collaborative working that HE is trying to encourage. We **recommend** that the guidance and contractual arrangements in relation to BCR are considered to mitigate the potential for gaming, and that the process to be adopted for reaching a consensus are clear.
- It is proposed there will be a lump sum fee for design development, including statutory processes. The logic for this approach appears to be the concern that this stage has historically been subject to higher than necessary costs, with a suspicion of unnecessary optioneering or over-design by designers, and no incentive to deliver savings if services are cost-reimbursable. The Panel understands these concerns. But it is also a stage in the process that is pregnant with risk (ie the strength and substance of any statutory objections; the cooperation or opposition of vested interests; the organisational abilities of environmental campaigners; the uncovering of unexpected hazards or contamination during ground investigation etc.) Furthermore, most commentators who have examined construction cost efficiency believe that the greatest opportunity to

influence outturn cost is during the early stages of design, and that too often this stage is not given sufficient attention or budget. Ringfencing this as a lump sum seems to be sending the opposite message to bidders. It was mentioned that DIPs would be free to decide themselves to increase design development costs if risks materialised, but with no change to the scheme cost. The resulting internal friction between the DIP's design teams and construction teams might be difficult to manage and have an adverse impact on collaboration. The Panel **recommends** that these issues should be considered, and we would welcome sight of the market engagement report on this point which may serve to allay our concerns.

- The DIP's fee covering overhead, profit, and risk is always an area of soul searching for both the authority and the supply chain. For the industry to move on, it needs to be adequate to allow both for the professional management of risk and adequate investment in skills and processes. We understand that this is also going to be evaluated on a 'sustainable' basis (i.e deviation from mean basis). In principle this is commendable, but does the industry know how pitch this in a competitive environment to get the desired effect? See our comments in para 20.3.

14.6 At the review meeting, there was considerable emphasis on the gain opportunity for DIPs, but less on the pain implications (which will be of particular interest to bidders). The Panel understands there are proposals to cap pain at the overall fee level, and we will wish to review these carefully once we see the IFT documentation to ensure there is a reasonable balance of risk and reward.

14.7 We are not clear as to whether the above commercial arrangements have already been approved at Board level (ideally this should have occurred when the Procurement Strategy was approved). If not, and there is still scope for change, the Panel **recommends** that careful consideration is given as to how the arrangements can be simplified.

14.8 Overall though, the Panel is impressed with the commercial and incentivisation arrangements developed for this procurement although it is something of a step-change to current practice. We know that HE is aware that this will require significant culture change and training, not only for the contracting industry and its supply chain but also for HE and its technical advisors.

15. Performance Regime

15.1 The performance management arrangements were explained in the presentation and the Panel commends the emphasis on objective metrics on which to measure the balanced scorecards. Encouraging a cottage industry of data managers finessing the results is not in the interests of either party. We look forward to seeing a pragmatic set of indicators in the ITT documentation.

16. Tender Qualifications and Mark-ups

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17. Lotting Arrangements

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18. Allocation of Contracts from the Framework

18.1 The Panel understands that initial packages for the various lots will be awarded immediately after the award of the framework lots. This will be facilitated by package-specific quality bids submitted in parallel with the tender responses for the framework.

18.2 Thereafter, for further packages it is intended that allocations will be made on the following basis:

- where there is insufficient performance data (see bullet below), allocation will be via a mini-competition based solely on quality / technical criteria; and
- where there is sufficient data on the performance of all DIPs in the framework, allocation will be based on DIP performance, with the best performing DIP being offered the first opportunity to submit a scheme delivery plan which HE will accept or reject based on quality, capacity and capability.

18.3 The Panel is relaxed about these proposals, because the regulations give reasonably wide scope in terms of the methodology to be used by contracting authorities for allocating contracts from a framework - **provided** the methodology is clearly articulated in the framework agreement (and, we would **recommend**) in the IfT.

18.4 Our only observation is that, given the lead times of some schemes (including the need to progress through statutory processes) and the requirement that all DIPs in the framework will need to have had the opportunity to demonstrate performance during the construction phase (a timing / sequencing issue), the Panel wonders whether there will be much opportunity to allocate on a performance basis. However, that is simply an observation and we do support the inclusion of this method in the framework agreement.

19. Technical Evaluation Processes

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19.4 [REDACTED]

19.5 Accordingly, the Panel **recommends** that the guidance for each technical question and the associated scoring framework are carefully designed (in line with the guidance in footnote 6) and then stress-tested to ensure they are robust and readily useable by evaluators. We also **recommend** that the scoring framework is transparently explained in the IfT. We will be carefully considering these aspects during the next review.

19.6 The Panel understands that, following scoring by individual evaluators, there will be a consensus meeting to reach an agreed score and rationale for each question. There will then be a moderation meeting to ensure consistency across the various lots. We regard this as good practice, but **recommend** that the system is carefully designed to be robust, consistent and objective, and that the outcome is a single final score and rationale for each response by the various bidders. These processes should be outlined in the IfT.

19.7 The evaluation, consensus and moderation processes will require significant resources and we note that some of the evaluation will extend into the summer holiday period. We **recommend** that HE ensures it will have available sufficient numbers of knowledgeable subject-matter experts to act as evaluators as well as experienced people to lead the consensus and moderation workshops. All must receive comprehensive training, recorded in a register. All must declare any interests or connections with bidders (including interests of close family members) with robust measures to avoid conflicts.

19.8 The Panel **recommends** that all of this is incorporated into a Tender Opening and Evaluation Plan which is to be developed during the tender period and used as the basis for evaluator and moderator training.

19.9 The Panel was told that, after evaluation / consensus / moderation, there will be a validation process, lasting for one month, where HE will meet bidders to explore aspects of their bids, and that the outcome may be an adjustment to the moderated scores. We understand this has been standard HE practice for some years, but it is not a process normally used by contracting authorities. The Panel considers that, if it results in a change in score, there could be a risk of procurement challenge. We **recommend** that:

- this process is carefully reviewed to consider if it is really necessary;
- if so, it is reviewed for compliance by your legal advisers; and

- the protocols, including the circumstances and methodology for varying the scores, are transparently explained in the IFT.

20. Commercial Evaluation Processes

- 20.1 The Panel received some briefing on the commercial evaluation processes and will see the full model when we review the ITT documentations.
- 20.2 However, it does appear that cost submissions will be relatively complex including mobilisation lump sum, priced development phase risk, construction phase fee for overheads and profit and a priced basket of goods. Presumably this will feed into a cost model which will deliver a commercial total for evaluation purposes. The Panel **recommends** that the model is independently audited to ensure there are no defects in the calculation engine, and that measures are taken to avoid errors in transcribing the bidders' tendered inputs into the evaluation model. We will consider this again at the next review.
- 20.3 The Panel was told that HE is considering the evaluation of cost (including, we assume, the vitally important fee for overheads, profit, risk etc.) on a deviation from median basis⁷, rather than the conventional lowest cost approach. We understand the rationale for this, which is to avoid unduly competitive pricing which can encourage poor behaviours. However, it is novel approach among the major procurements we have reviewed. We are somewhat concerned that such a significant issue is still being considered relatively late in the procurement process.
- 20.4 Further, the thrust of regulation 67 of the Public Contracts Regulations 2015 (PCR) is that contracting authorities shall base the award of public contracts on the most economically advantageous tender assessed from the point of view of the contracting authority; that the tender shall be identified on the basis of the price or cost; and may include the **best** price-quality ratio. The Panel **recommends** that you consult your legal advisers to confirm the compliance of the proposal with procurement law.
- 20.5 We also **recommend** that HE considers the issue from the point of view of the tenderer. Under the conventional system, tenderers will bid their most competitive price based on their projected costs, desired profit and appetite for the contract. They know they must bid the lowest cost they can justify in the circumstances. But under the proposed system they will have no idea where to pitch their bid in order to achieve success, because that is determined by the median; it will be something of a lottery. The Panel supports the desire to discourage low-balling, but we wonder if there are other ways of achieving the same aim, perhaps by setting a floor for some of the key items such as construction phase fee percentage.

⁷ Deviation-from-median basis: that is, where the median bid receives the highest score and others are scored lower in proportion to their deviation from the median.

21. LoD2 Review

- 21.1 The Panel in its LoD3 role does not undertake a full page-turn review of the assurance documentation. It is a key principle of the 3 Lines of Defence assurance system that such a page-turn review is undertaken by a semi-independent LoD2 team on a relatively mature version of the procurement documentation (including the IfT, the evaluation criteria and associated guidance and the various draft framework agreements and contracts).
- 21.2 The Panel understands that the LoD2 review will be undertaken by a team comprising external procurement advisers (██████████), external legal advisers (██████) senior leaders from the commercial, procurement and performance workstreams and the RIP Programme Sponsor. We consider that these senior level reviewers will provide sufficient independence from those who have been involved in detailed drafting.
- 21.3 However, the Panel is concerned that:
- the LoD2 review is scheduled to commence on Tuesday 20 February – it is highly unlikely that the documentation will be in a sufficiently mature state to allow for a meaningful review; and
 - the schedule shows that the page turn is scheduled for 2 days with a further 4 days for reporting – given the extent of the procurement documentation, and the fact that the standard forms have been reasonably heavily modified, there is a high risk that insufficient time will be available for an effective review.
- 21.4 The Panel relies heavily on the LoD2 review (and the external legal assurance letter) in forming its own opinion on assurance and it is vital that we have confidence in the LoD2 process. Accordingly, we **recommend** that the timing and duration of the LoD2 review is carefully considered.

22. Preparations for LoD3 Assurance Review

- 22.1 The Panel's formal LoD3 Assurance review is currently scheduled for Monday 5 March 2018, but this will be subject to HE's consideration of our recommendations on timescale in sections 13 and 21.
- 22.2 As indicated in previous correspondence, we have the following requirements for advance documentation (ideally to be with us by close on 27 February, but given the time pressures we will be flexible):
- IfT main volume (near-final draft);
 - IfT key appendices, eg list of technical evaluation criteria and associated guidance (near-final draft);
 - any significant modifications to draft framework agreements and contracts (especially if novel or contentious);
 - guidance for awarding secondary contracts from the framework;

- LoD2 Tracker. This is a spreadsheet with a series of LoD2 issues classified as observations, minor concerns and major concerns. For each issue there would be a ref no, classification, brief description of issue, HE's response⁸ to the issue, date closed if applicable;
 - HE's response⁸ to the key observations and recommendations arising from this Panel Report should also be included in the tracker;
 - External Legal Assurance Letter. The Panel (and we assume HE) expects to see a letter which gives a definitive statement on the compliance of the ITT processes and near-final documentation with the Directive and Regulations. It is reasonable for this to be subject to a few issues (say 5 or 6) where the legal advisers see some risk and recommend measures to mitigate it (or record the measures that have been taken in mitigation). The Panel sees many external legal assurance letters; we are not impressed by heavily-caveated letters which raise numerous risks and issues without giving an overall opinion as to compliance.
- 22.3 It would be helpful if a senior representative from the LoD2 team could attend the next Panel review meeting to provide further detail and commentary on the LoD2 tracker. [REDACTED] have done this for other assurance reviews and it has worked well.
- 22.4 Following the Panel's assurance review we will provide a letter of assurance to the [REDACTED] in relation to the ITT principles, processes and documentation. This will set out our opinion on assurance in line with the definitions in Annex C⁹, together with our rationale, discussion of key issues and recommendations.

Conclusions

23. The Panel recognises the crucial importance of the RtM programme and the DIP procurement in supporting HE's successful delivery of the RIP.
24. We have been impressed by the quality of the RtM team, and the innovative and commercial thinking they have developed to drive collaborative behaviours and achieve common goals over a relatively long-term – the 6 years of the framework and the tail of contracts awarded under it.
25. We commend the team for taking account of the good practice principles that have emerged from recent UK major construction programmes, lessons learned from previous HE/HA frameworks and feedback from the market.

⁸ The Panel does not expect HE to accept or address every single one of the LoD2 / Panel issues. This is a matter of judgement for HE. However, if many are dismissed the Panel will draw conclusions as to responsiveness.

⁹ You will note from Annex C that one of the reasons for an opinion of 'no assurance' is if documentation and plans / processes are not sufficiently mature to allow an opinion on assurance to be given.

26. However, the Panel has some significant concerns:

- 26.1 The commendable desire to adopt this good practice appears to have resulted in rather complex commercial principles (incentivisation, performance management, etc). The complexity brings the risk that the parties may lose the clear line of sight that is necessary to ensure that incentives drive the correct behaviours, as well as the risk of unintended consequences and disputes that could last for the length of the framework and beyond, undermining the collaborative relationships that HE is seeking to achieve.
- 26.2 The timescales for the procurement are over-ambitious. They are tight for a normal procurement and ambitious for one that is at the upper end of the scale of current major construction procurement and is more complex than most. HE should take a view as to whether wishes to press ahead to meet these ambitious timescales (and risk weaknesses in the processes or documentation which could increase the risk of a procurement challenge or contractual difficulties over the relatively long term of the contract), or if it should take some time to ensure the processes and documentation are maturely developed and properly assured.
- 26.3 There are some concerns about both the technical and commercial evaluation proposals. These must be robust, consistent and defensible to avoid procurement challenge.

27. The Panel hopes that the observations and recommendations we have made throughout this report will help HE to address these concerns. We look forward to undertaking the formal assurance review at the appropriate time.

Yours sincerely,



Chair – Independent Assurance Panel

Definition of Assurance Levels

Substantial assurance: the Panel tends not to offer this level of assurance mainly because it does not itself undertake an exhaustive review of all documentation, and places significant reliance on others (see below).

Reasonable Assurance: the Panel offers this level of assurance where it feels the documentation and plans / processes are of a good standard (bearing in mind that it has not undertaken an exhaustive review but relies on the LoD2 reports and external legal letters as well as its own review of selected key aspects of the documentation). It is usually subject to a number of observations and recommendations, which in the Panel's opinion are capable of being readily addressed by HS2.

Limited Assurance: the Panel offers this level of assurance where it has one or more major concerns*, or feels that the some aspects of the documentation and plans / processes require significant further development. The Panel will set these issues out in its observations and recommendations. It is likely that HS2 will be capable of addressing these through further careful consideration.

No Assurance: the Panel will withhold assurance if has numerous major concerns* or believes that the documentation and plans / processes are not sufficiently mature to allow an opinion on assurance to be given. The Panel would expect to be asked to undertake a further review once the various issues have been addressed.

* A 'major concern' is a matter which, if not addressed, is likely to result in a high risk to the success of the procurement exercise or to value for money.