

Her Majesty's Treasury

*Getting best value from*

TRADE SALES  
AND  
STRATEGIC  
PARTNERSHIPS

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## PREPARING FOR A TRADE SALE OR STRATEGIC PARTNERSHIP

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## 1 Introduction

- 1.1 A range of legislative, commercial and propriety issues arise when a public-private partnership (PPP) is formed from a public sector business or service. This guidance deals in particular with tradesales, either an outright sale or the creation of a partnership through sale of a majority stake or a minority stake to the private sector. In particular, it provides guidance on some key administrative and commercial issues arising in a trade sale direct to a commercial buyer, including a management and employee buyout consortium (MEBO) (see paragraph 3.3 and Annex 2).
- 1.2 Departments should look for more detailed advice to their externally appointed advisers. A list of government contacts who can advise on specific issues such as competition policy, public purchasing and propriety is at Annex 1.
- 1.3 Lessons which the NAO has drawn from examinations of sales of state-owned businesses are set out in the sixty-first report from the committee of public accounts: “Getting value for money in privatisations”.

## 2 Responsibility for the sale process

- 2.1 The vendor of a nationalised industry, agency or civil service function will be responsible for setting objectives for the sale and managing the sale process. This will normally be a Government department. The appropriate Secretary of State will have overall responsibility for the sale.
- 2.2 Where a department has agreed that a nationalised industry, agency or other public sector body may be the vendor, that body will be responsible for the direct management of the sale process. However, the sponsoring department (or appropriate Minister) will have overall responsibility for ensuring that the sale arrangements achieve value for money and that all wider questions affecting the public interest are considered. A department will therefore generally draw up its own objectives for the sale and appoint its own expert advisers. The department will remain responsible for securing any necessary legislation, and its specific consent may, under statute, be required for the sale by the public body concerned.
- 2.3 Departments will, in all cases, have a responsibility to keep Parliament informed of their plans.

## 3 Methods of sale

- 3.1 A precursor to a decision to establish a PPP may be a review of the organisation concerned. Full guidance is available in “Better Quality Services Handbook” and “Better Quality Services Senior Managers Guide” published by TSO.
- 3.2 Following the decision to establish a PPP, when this involves a sale of a share in or all of the business, the vendor department will need expert advice on the method of sale (usually a matter to be discussed in a feasibility study). The advice will normally consider two broad alternatives:
  - (i) a public flotation: There are significant costs involved in sponsoring a listing and subsequent public offer of shares (particularly where the department contemplates directly marketing the shares to the public). In addition, the vendor does not receive a premium for control of the business which a single trade buyer might be prepared to pay. Flotation may therefore be most suitable only for the very largest businesses

(and then only when there is a sufficient track record of profitability to ensure good sales proceeds) although it is well worth assessing the potential costs of and proceeds from the flotation of smaller businesses. The institutional investor will generally expect to see a well-managed, profitable industry reflected, for example, in its commercial accounts. In addition, the disclosure requirements for a public offer for a sale prospectus are necessarily strict to protect the less sophisticated investor; and

- (ii) a trade sale: This is a sale of all of, or a share in, the business directly to a single commercial buyer or consortium, and is the sale option with which this guidance is primarily concerned. A trade sale is less driven by market precedent than flotations; there is therefore greater responsibility on the vendor to ensure that the terms and conditions of the sale are such as will ensure policy objectives are met and maximise value for money. A commercial buyer may be in the same business sector or may be seeking to diversify into the sector. Trade purchasers are generally knowledgeable investors, may pay a premium for control, and are usually prepared to buy a business which has potential for cost and revenue improvement. As a private contract sale, there are no statutory disclosure requirements. Vendors may choose to disclose in the Information Memorandum for the sale as little as purchasers will accept to put a sound value on the business, but good information is essential for a competitive sale. Moreover, standards of accuracy must remain high to avoid the risk of litigation in respect of negligent or recklessly misleading statements (see paragraph 26.2).

- 3.3 Departments may allow or wish to encourage a Management and Employee Buyout (MEBO) to participate in a trade sale competition. A MEBO is a group of managers and employees, acting either on their own or in conjunction with a consortium, who purchase, and carry on for their own profit, the business in which they have previously been employed. The management and employees will hold a substantive shareholding in the new company. The main reasons for entertaining bids from a MEBO are to provide the opportunity for employees to benefit, to increase the level of competition in order to maximise sale proceeds and to encourage the commitment of management and staff of the organisation in the run-up to the sale and their participation in the PPP. A MEBO bid can also send out a very positive signal about the value of the business. However, possible conflicts of interest have to be addressed (see section 11). Issues relating to MEBO bids are discussed in more detail in Annex 2.

## 4 Identifying the business for a PPP

- 4.1 The department will usually conduct a feasibility study (see section 6) into the viability of a business to be part of a PPP. Where appropriate, the feasibility study may also address options such as contracting out. The feasibility study is normally carried out by an investment bank, accountancy or other appropriate consultant appointed following competitive tendering.
- 4.2 Before commissioning a study, the department should seek to identify those activities which cannot reasonably be part of a PPP because, for example, they constitute a core policy or regulatory function. No financial adviser will have full competence to make this judgement although they may subsequently help to define the boundaries. However, the department, and not the financial adviser, will be able to judge whether legislation will be required.
- 4.3 Where a function must remain in the public sector, contractorisation (either in whole or in part) may be an alternative. The study should examine whether there is scope for transferring assets, as well as staff, to the contractor.
- 4.4 The protection of staff interests is discussed in section 21 below.

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## 5 Objectives for the PPP

- 5.1 Before proceeding with the feasibility study, the department should give initial consideration to its objectives. These will need to be defined in the light of Ministerial decisions on the PPP. Objectives should be agreed with the relevant Treasury team.
- 5.2 The department should ensure that objectives encompass the main purposes of the PPP so that their achievement can be measured. They may typically include service, investment and other policy functions which the PPP is expected to fulfil; financial criteria such as maximising sales proceeds and limiting guarantees and contingent liabilities, but also, for example, wider national interest objectives and objectives for the competitive structure of the industry after the PPP is established and for the treatment of staff depending on the circumstances of the individual sale.
- 5.3 Objectives can sometimes compete with one another, for example, maximising net proceeds, maximising service obligations, meeting a demanding timetable and maximising competition. The department should plan how to resolve such conflicts, including where possible ranking objectives in order of priority, and this should be put to Ministers for a decision.

## 6 Conducting a feasibility study

- 6.1 In appointing a financial adviser to conduct the feasibility study, departments should have regard to the requirements of the EC Services Directive and the presumption that the appointment of external consultants should be on a competitive basis. For advice on these issues, departments should refer to their own purchasing unit in the first instance. Departments might also find it useful to refer to Treasury Taskforce Technical Note No. 3 “How to Appoint and Manage Advisers” which is aimed at Private Finance Initiative projects, but contains some more general principles. Also, Central Unit on Procurement (CUP) Guidance No. 51, available from Office of Government Commerce, gives an introduction to the EC Procurement Rules.
- 6.2 The department should obtain adequate confidentiality undertakings from financial advisers that information made available to them during the feasibility study stage will not be used in any other exercise, such as assistance to a potential purchaser in preparing a bid and in subsequent negotiations. The department should also ensure that any candidate for appointment as financial adviser is not employed by anyone who has expressed, or may express, an interest in the purchasing business.
- 6.3 The appointed adviser may offer strategic as well as operational advice, and may be asked to comment in the feasibility study on issues such as:
  - the viability of the business or parts of the business that might be sold (in any case one of the issues in a feasibility study will be whether the business should be sold as a whole or in parts);
  - the scope, if there is time before the sale, for introducing a more commercial orientation or for remedying accounting or other deficiencies;
  - the need to adjust the capital or management structure of the business (although a capital restructuring has usually been the exception in trade sales);
  - competition issues (these are discussed further in section 18);
  - the structure of the PPP that will best meet the policy objectives, including the proportion of the shares to be sold and where control of the business will lie;

- the method of sale and the likely level and sources of demand;
  - options for timing of the sale and the implications, if any, for proceeds;
  - an approximate indication of likely proceeds and costs to assist in deciding whether to proceed to sale and/or in decisions relating to the viability of the business; and
  - if the public sector is to retain a stake in the business, a consideration of liquidity issues and exit provisions.
- 6.4** The department should give the appointed adviser:
- copies of relevant management information and accounts;
  - an explanation of the department's objectives for the sale;
  - an account of any novel solutions proposed by other candidates during the appointment process which may be worthy of further study; and
  - any other relevant information.
- 6.5** The department will normally arrange for the appointed adviser to have full access to the managers and information systems of the business to be sold, to any important public sector customers and to the departmental sponsor team.
- 6.6** The appointed adviser should normally be asked to forward a first draft of its feasibility study to the department for discussion, clarification, expansion and amendment as necessary. This to ensure that all aspects are covered satisfactorily in the final feasibility study report.

## 7 Advisers to the sale process

- 7.1** When Ministers decide, following the feasibility study report, that the PPP should be established on the basis of a trade sale, the department as vendor will generally need to appoint:
- (i) a financial adviser. The vendor may wish to consider asking the firm which completed the feasibility report to handle the sale itself, provided the initial appointment was made with an eye to the handling of the sale itself and the firm has the necessary expertise. In doing so, however, departments should consider whether it would be foregoing any benefits that could arise from a full competition (for example, in relation to fees) and whether continuing the appointment would be consistent with the requirements of the EC Services Directive. The department would also wish to be satisfied as to the quality of the team members who will handle the main sale and that no conflicts of interest had arisen since the feasibility study stage. The department should also:
- obtain adequate confidentiality undertakings from financial advisers that information made available to them during the sale process will not be used in any other exercise such as the assistance to a potential purchaser in preparing their bid and in subsequent negotiations;
  - ensure that any candidate for appointment as financial adviser is not employed by anyone who has expressed, or may express, an interest in purchasing the business (whether as a third party purchaser or as a MEBO team).
  - furthermore, to guard against the risk that any advice given by a financial adviser might be biased with a view to gaining future employment, it may be prudent of the vendor to

impose a condition of appointment to ensure that neither the financial adviser, nor any director or employee of the financial adviser working on the sale, can take up employment with the PPP for a period of, say, two years after the sale, without the specific consent of the vendor. It may be difficult to monitor and enforce these conditions, but vendors should seek to mitigate potential conflicts of interest as far as they possibly can.

- (ii) a legal adviser: responsible, inter alia, for verifying the legal title to real and intellectual property held by the business and for drawing up the sale and purchase agreements. The Department's usual legal advisers should be consulted on the appointment process;
- (iii) a reporting accountant: responsible, inter alia, for producing accountancy information on the viability and prospects of the business, and on any guarantees or contingent liabilities.

**7.2** Other technical or project management advisers may be required as appropriate. For example, a property valuer may be needed to advise on, inter alia, the value of land and buildings both under existing use and in anticipation of developmental gains (see paragraphs 15.6 and 15.13). An actuary may be required to advise on the merits of any pension scheme proposals (see section 21). Specialists such as in IT or transport may be required, depending on the business involved. Occasionally, a public relations adviser has been appointed in relation to major trade sales although this is not a common requirement. Treasury Taskforce Technical Note No. 3 gives examples of the roles of advisers.

**7.3** The department should agree that the nationalised industry, agency or other body may act as vendor in a sale only when a small subsidiary is being sold. In this case, the department will normally wish to appoint its own separate financial and other appropriate advisers, apart from those appointed by the vendor. This is because conflicts of interest are inevitable, and departments will not be able to rely on advice in assessing value for money if the same advisers are serving the organisation of which part is being transferred to the private sector.

**7.4** The vendor will need to ensure that advisers' appointment terms help achieve the department's objectives. This may include an element of success fee. However, the vendor should consider carefully how "success" is defined. For example, it should not be defined in relation to realising a valuation prepared by the same financial advisers - any such target should be independently established. Nor should it allow the proceeds to be maximised at the expense of service provision or other policy objectives. There may also be a risk of introducing perverse incentives for advisers to press to complete the sale even if this is not in the vendor's best interests.

## 8 Departmental accounting and reporting lines

**8.1** When a decision to establish a PPP has been made, the vendor department must establish proper lines of accountability for those running the business up to the point of sale, and for those conducting the sale itself. Departments should consider:

- the need for a separate PPP team and the quality of financial and other information available to the team;
- the accounting officer arrangements; and
- additional control procedures where management is participating in a MEBO.

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## 9 The role of the PPP team

- 9.1 The department should generally take steps to separate responsibility for selling the business from responsibility for running the business by setting up a PPP team. The PPP team's task will be to conduct the sale such that all potential purchasers (including any MEBO) are treated equally. However, oversight at a senior level in the business and in the department will be required to ensure that the business is not run in a way which would prejudice the PPP.
- 9.2 Where a department is the vendor of a civil service, agency, or NDPB function, it should ensure that the PPP team has a reporting line separate from that of those managing the business. The PPP team may need to establish new reporting and communication channels, as well as planning, monitoring, and information systems to ensure that senior management, Ministers and Parliament are kept properly informed about the progress of the sale.
- 9.3 The PPP team should have full access to information relevant to the business being sold, should receive copies of all regular management accounting reports and management board papers and should be informed in advance of all proposals (such as capital projects or continuing commercial contracts) which are likely to influence the value of the business being sold. The PPP team's approval should be required for the release of information to all potential purchasers, including the financial backers of a MEBO, and for all decisions which could have an impact on the sale.
- 9.4 Where a department is vendor of a nationalised industry or other non-central Government function, there is generally already a clear separation between the managers of the business and its owners, and annual reports and accounts are published for the business. The department, nevertheless, will need a separate PPP team to manage the sale. The PPP team should consider whether there is adequate monitoring information on the finances of the industry. For example, it will be important to identify guarantees issued by, and contingent liabilities falling on, the Government, and to seek to bring these to an end when the PPP is established.
- 9.5 Where a nationalised industry or other body is vendor in the sale of a subsidiary or other discrete part of the business, the roles of each party should be clearly defined at the outset. The department may decide to issue guidelines, whether statutory or otherwise, on disposal arrangements and to require the Secretary of State's consent for the sale. The department should monitor the vendor's handling of the sale to ensure that agreed procedures are applied properly in all key respects. It may also wish to strengthen arrangements for the receipt and discussion of monitoring information between the department and the industry concerned, with a view to ensuring that due regard is paid in the running of the business to any potential effect on sale proceeds. In particular, departments will wish to consider the need to appoint one or more independent directors to the board of the subsidiary (see paragraph 11.7).

## 10 Accounting Officer arrangements

- 10.1 The Accounting Officer for the Vote on which expenses related to the sale are brought to account should be the Permanent Secretary of the vendor department.
- 10.2 The Accounting Officer's responsibility for the current activity of the business will depend on its nature, scale and status. If it is a relatively small part of the department, carried on only part of a Vote, then the Accounting Officer will normally continue to be the

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Accounting Officer of that Vote. If the Chief Executive of the business is the Accounting Officer for a separate fund or Vote on which the business is carried, or has been appointed as an agency Accounting Officer or as an additional Accounting Officer, then it will normally be appropriate for a new Accounting Officer to be appointed.

## 11 Management and Employee Buyouts

- 11.1** The vendor will need to consider whether to allow bids from a MEBO team, weighing up the likely benefits to the sale of increased competition and its objectives on employee participation against possible conflicts of interest. If management is bidding for the business, it will have less time to devote to running the business. It might also have an incentive to depress the performance and value of the business to lower the level of competing bids. If management does form a MEBO, it should be encouraged to involve employees as widely as possible.
- 11.2** If a MEBO bid is allowed, the vendor will need to ensure that arrangements are in place to ensure that all relevant management information is passed out to external bidders. The vendor may also wish to consider placing a limit on the incentives, including their stake in the MEBO, which venture capitalists may offer management to join their team and form a MEBO, since such incentives may reduce the value which the venture capitalist is prepared to bid for the business and hence the value received by the public sector. Alternatively, where the management team is interested in participating in a MEBO, the department might wish to consider itself holding a competition to select a venture capitalist partner.
- 11.3** All officials of a central Government function being transferred to the private sector who are (or who contemplate becoming) members of a MEBO team bidding to purchase the business should be asked to declare their interest in writing. Written instructions should be issued to all concerned with the business on issues such as:
- the need to avoid conflicts of interest;
  - the rights of access of the PPP team (and its professional advisers) to information about the business;
  - the release of information to all potential purchasers and their backers on a fair and equal basis; and
  - employees' continuing duties of confidentiality and loyalty to the Government.
- For example, where a Chief Executive intends to play a part in the MEBO, he or she will, up to the moment of sale, retain an obligation to conduct the business in the interests of the Government as the present owner.
- 11.4** Draft written procedures for potential MEBO participants are attached at Annex 3. Departments will wish to adapt these for their own use.
- 11.5** Where the Chief Executive of the business being sold intends to participate in a MEBO, the department should consider taking additional steps to ensure that the PPP team is adequately informed about the decisions taken within the business. Appropriate arrangements should be agreed case by case with the relevant Treasury team. The arrangements may include appointing a representative of the vendor to the board or top management group of the business to be sold; designating a senior manager within the business to be sold who would undertake not to participate in the MEBO and who would

ensure that the vendor receives all information relevant to its functions; otherwise stationing within the business to be sold a representative of the vendor with powers to see all relevant papers; and/or giving the vendor power of direction over the internal auditors of the business to require them to investigate specific activities by location or function, and to report a true and fair view.

- 11.6** Separately, the Accounting Officer responsible for selling the business should arrange for the department's internal audit team to be notified of the proposed PPP so that the sale arrangements can be included in their programme. He or she may also decide to notify the National Audit Office and provide updated information from time to time to assist in preparation for their expected post-sale investigation.
- 11.7** The PPP team will also wish to consider whether any special arrangements are required if a MEBO is contemplated by a nationalised industry. For example, if the Chief Executive intends to participate in a MEBO team, it will be essential to appoint one or more independent directors to the board of the nationalised industry. The role of independent directors is to offer the department a clear view of the viability and prospects of the business against which views expressed by the MEBO and/or other purchasers might be assessed, and to help to ensure that all potential purchasers have equality of information. These posts should be wound up on the completion of the sale. If independent directors are not appointed, the department will need to agree with the relevant Treasury team other arrangements to protect its position and to ensure that all purchasers face a level playing field.

## 12 Arrangements to manage the sale process

- 12.1** Departments should ensure that the roles of each party (that is, the department, the entity to form the PPP and their respective advisers) are clearly defined from the outset. This may be particularly necessary where a separate business or agency, and not the department, is vendor in a sale.
- 12.2** The department will wish to ensure that there is a steering group, and any other committee structure that may be necessary, reflecting the appropriate division of responsibilities to ensure proper control over the sale strategy and to allow active monitoring by the department of the changing circumstances of the sale process.

## 13 Sale costs

- 13.1** Departments should make early arrangements to ensure that sale costs can be separately identified, forecast and monitored.
- 13.2** Where advisers are paid by means of a success fee arrangement, vendors should consider carefully the risks involved in linking them to particular valuations. In particular, in setting thresholds which trigger success fee payments, they should ensure that:
- the valuations used reflect best estimates of likely proceeds rather than lower benchmarks; and
  - consideration is given to the need for endorsement by an independent party aware of all the purposes of the valuation, including any link to success fees.
- 13.3** Further advice on Vote, PES and cost issues can be obtained from the Treasury.

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## 14 Rationalising the business and its systems before sale

**14.1** Departments will normally have given initial consideration to rationalisation of the business at feasibility study stage (see paragraph 6.2). Informed decisions on preparing a business for sale can contribute significantly to its saleability and subsequent performance in the private sector. At the sale preparation stage, the vendor will need to implement any decisions to:

- revise the management structure and to introduce new working practices. Existing management may lack the expertise to operate in a fully commercial environment;
- alter pay arrangements. Since 1 April 1996 departments have been responsible for their own pay arrangements, but should consider whether more flexible pay systems would help to support new management structures and working practices;
- restructure the business, implementing decisions to rationalise or to separate out assets for retention in the public sector or separate sale;
- relocate. Departments should consider carefully the costs and benefits of relocating existing centres of operation, including the impact of possible changes to the timing of sale;
- reform accounting procedures. Public sector cash accounting typically falls short of normal commercial accounting standards, and substantial work may be needed to introduce commercial style accounts. Accounting adjustments and improvements in the quality of information gathering and reporting may be needed;
- introduce an appropriate capital structure (this is not usually a requirement in most trade sales);
- ensure that contracts, particularly those with existing customers, are amended to reflect as commercial and professional an approach as possible (ie service contracts as opposed to memoranda of understanding);
- firm up business plans, to assist bidders' valuation of the business, whilst ensuring that they are not over-optimistic and open to misinterpretation;
- deal with any debtors and creditors – both those being transferred with the business where change of ownership clauses apply, and those which are not being transferred;
- deal with any sector specific issues, for example environmental audits; and
- commission an actuarial valuation, if necessary.

## 15 Structure of the PPP

**15.1** The department will have considered the structure of the PPP at the feasibility study stage (see paragraph 6.2). In developing the structure in detail, it will need financial advice on areas including the following to ensure the public interest is protected.

**15.2** **The proportion of the shares to be sold.** If Government has decided that control should remain in the public sector, then only a minority stake will be sold. Otherwise, the potential of the business, and hence value from the sale, is likely to be maximised by giving the private sector control through a majority or outright sale. However, the vendor may want to retain a minority stake to share in the profits of the business after the sale. This allows the department to share in all the profits made by the business, including any improvements in performance

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which are achieved following the sale. At the same time, the new management's interests are in maximising the value of that share. Retention of a stake also mitigates the potential loss to the public sector from the risk of selling the business for less than its full value, which may not become apparent until the business is operating in the private sector. At least part of the retained share might be realised in a subsequent sale. There will, however, be issues to be considered about the extent of rights retained by a minority shareholder (where the majority is acquired by a single buyer or consortium), how compatible these are with classification to the private sector (see paragraph 15.9), and the potential for future exit.

**15.3 The need for a clawback provision.** Such arrangements may cover:

- profits of the business, or from any on-sale of the business;
- profits from sale of land or property which is sold with a possible alternative use;
- intellectual property rights;
- financial impact of potential changes after a sale.

*Profit clawback*

**15.4** Financial advice should be sought on whether best value would be obtained by including a clawback over “super-normal” profits or over gains from any on-sale of the business. That advice should cover:

- the potential for there being value in the business not properly reflected in bids which might be captured by a clawback; for example, possible windfall profits or unexpected gains in profitability. The PAC has criticised the conduct of sales where such gains have materialised after the sale, but were not subject to any clawback;
- the likely effect of the clawback on the sale proceeds and interest in the sale. It should be borne in mind that any reduction in proceeds is a cost to the taxpayer, whereas the future potential return from a clawback is inevitably uncertain. However, it might be possible to set the threshold (or tapering thresholds) for any clawback at a level in excess of a normal return which bidders might expect to make, but to share in any super-profits, so that sale proceeds were not significantly depressed;
- the duration of any clawback provision, and whether a tapering clawback would be appropriate. The duration should not be so long as to restrain the growth and development of the business after the sale, for example by removing the incentive to invest in the business and increase its value. This would also reduce the sale proceeds;
- the complexity of a clawback mechanism and the scope for avoidance (for example, by manipulating reported profits to fall below any clawback threshold);
- the practicality of a clawback, for example if the purchaser wishes to merge the acquired business with another business.

**15.5** A decision on whether to include a clawback should be made after weighing up these considerations and in the light of whether the public sector will be participating in the profits of the company after the sale through retention of a minority stake.

*Land or property*

**15.6** Clawback where land or property with an alternative use is sold with the business has been the most common form of clawback arrangement in Government sales. Such arrangements have

typically provided for claw-back of a percentage of any development gains over 10 years after the sale. The base value from which clawback provisions are applied is normally the existing use value at a specific date with property based indexation. Clawback liability can be calculated by reference to a proportion of the gain over base value. A typical arrangement might be 75% over the first 3 years, 60% for the 4th and 5th years and 50% for the last 5 years.

#### *Intellectual property rights*

- 15.7** Clawback arrangements can also be applied to the income from intellectual property rights. In such cases, the department seeks to obtain a future benefit from the company's main source of income based on the technologies held in the company's portfolio at the time of the sale. It may be inappropriate if these relate to items such as computer software, building or site specific information or manuals which would be needed by the business and which are unlikely to generate any specific windfall gains.

#### *Financial impact of potential changes after a sale*

- 15.8** Clawback arrangements can also be put in place to cover unrealised bidders' concerns about the financial impact of potential changes after a sale. Where the vendor forgoes proceeds in recognition of such concerns, the vendor should consider putting in place arrangements to claw back the amount foregone if the bidder's concerns remain unrealised.
- 15.9** **Shareholders' agreement.** Where the business is not sold outright and the vendor retains a stake, financial and legal advice will be needed on the shareholders' agreement which will govern the relationship between the vendor and the private sector partner. If a majority stake is being sold, it will be important to ensure that, if appropriate, the shareholders' agreement allows the private sector partner to exercise control over the business whilst safeguarding the public sector's financial interests (for example, in respect to dividend policy). Proceeds will be reduced if the shareholders' agreement puts too many or unnecessarily intrusive controls over the private sector partner. Such controls also increase the risk of the PPP being classified to the public sector for National Accounts purposes.
- 15.10** **Corporate governance.** If control is being passed to the private sector partner then the partner will expect to have the power to appoint the chairman of the board and the executive directors. However, the shareholders agreement may give the vendor as a minority shareholder certain powers over the corporate governance, for example the right to veto the appointment of executive directors and to appoint some non-executive directors to represent the public sector's interest on certain key issues on which board unanimity would be required.
- 15.11** **Exit arrangements.** Following a trade sale, there will be no liquid market in the shares in the company. The public sector needs to ensure that it has an exit route if it decides to sell its stake in the future. This may include the right to sell the shares to the private sector partner with a specified mechanism for setting the price or, under certain circumstances, the right to require a float of the company. Either partner may have preemption rights if the other partner wishes to sell (although the department will need to consider whether it would be in a position to exercise such rights if necessary, for example given funding constraints.)
- 15.12** **Service obligations.** The Department should consider how best to ensure that its policy objectives in relation to the service to be delivered by the PPP are met. Use may be made of:
- service agreements;
  - licences;
  - safety regulation;
  - economic regulation.

**15.13 The treatment of property assets.** In particular, departments should consider:

- the best treatment of both operational and (currently and potentially) surplus land and buildings. There may be arguments in proceeds terms for the vendor to dispose of certain properties separately from the main sale. However, departments should consider whether piecemeal sale would risk leaving an unsaleable rump in public ownership; the practicability of the separate sale of sites which may be operational sites at the time of sale; and the restructuring and relocation costs that may be involved in making sites available for separate sale;
- the arguments for introducing clawback arrangements (see above) or for retaining certain assets in the public sector;
- the existing use and development values of the properties which may be sold, in order to inform these judgements (and other decisions in the sale process). Departments should ensure that the timing of such valuations will ensure they remain valid in relation to the planned timing of the sale;
- obtaining improved planning consents, in appropriate cases, to maximise the value of any surplus land or property sold;
- a legal search of titles to property to ensure that the business has rights to all the operational property it needs. Legal searches should begin as soon as possible in order to avoid delays later on.

## 16 Legislation

- 16.1** For the sale of nationalised industries, agencies or civil service functions, advice should be sought from Government lawyers at an early stage on the need for specific legislation. A range of statutory provisions may be necessary or desirable depending on the nature of the business being sold and the sale arrangements. A study of past legislation will reveal a number of provisions which may have relevance.
- 16.2** Where nationalised industries not already in Companies Act form are being sold, provisions may be needed:
- to explain how the initial investment in the successor company arises, and to treat the shares as fully paid (ie as if they had been subscribed in cash);
  - to make vesting effective from the end of the previous financial year to avoid the need to prepare accounts at an interim date;
  - to eliminate a charge for Stamp Duty where the Treasury is satisfied that the increase in the capital of the successor company arises in consequence of vesting;
  - to carry over the value of assets and liabilities;
  - to treat the successor company for all purposes of Corporation Tax as if it were the same person as its predecessor;
  - to provide for borrowing by the successor company up to, but not beyond, the point of establishing the PPP; and
  - to provide for any necessary legislative check on changes in government's shareholding.
- 16.3** Provision to vest assets by means of a statutory scheme might also ease the difficulties which might otherwise arise (e.g. the assignment of leases by third parties).

## 17 New service rules

- 17.1** Departments should be aware of the new service rules in Chapter 2 of Government Accounting. This covers expenditure on a new service which Parliament has not (yet) authorised.

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## 18 Competition policy

- 18.1** In planning for the PPP (usually at feasibility study stage), the department must ensure that, in addition to compliance with EC Procurement Rules, the requirements of competition legislation (e.g. the Fair Trading Act and the Competition Acts) will be observed and that the competition policy implications for the relevant market(s) have been addressed. Departments may wish to consult the competition policy division of the DTI. Departments should consider whether:
- it will be necessary to split the business before sale in order to ensure that a public monopoly (subject to the framework of control and accountability imposed on publicly owned businesses) is not transferred wholesale into the private sector without the counterbalance of a free competitive market or, in appropriate cases, regulation;
  - the confidence of investors in the sale could be undermined if there was concern over future review of the business by the competition authorities; and
  - the nature of any prospective buyer's own business would mean that buyer wielding undue market power, with the attendant risk of abuse of that position.
- 18.2** If it is likely that a merger will create a company with too dominant a position in the market, any sale and purchase agreement may be subject to referral to the Competition Commission and/or the European Commission.
- 18.3** There may be policy reasons to restrict the range of purchasers. This might be the case when the business being sold offers advisory services whose unique selling point is their independence of supplying industries, or when the Government desires to establish a competitive market by splitting up a single national organisation into regional components and imposing a "no contiguity" rule (whereby no purchaser can buy two regions with a common boundary). Any such restrictions will have to take account of, for example, EU and international obligations in relation to potential overseas purchasers and would need to be cleared with legal advisers.

## 19 State aid

- 19.1** Departments should seek early advice from DTI on all cases where there may be the provision of state aid to the business as part of establishing the PPP or afterwards. Instances which are likely to fall under the EU state aid rules include transactions involving a cash injection, debt write-off, or other capital reconstruction, or where a loss-making business may have to be sold for negative net consideration rather than be closed, or where price preference for a MEBO has been given (see Annex 2).
- 19.2** Member States are required to notify the European Commission of plans to grant or to alter aid. Failure to notify an aid to the Commission sufficiently in advance may lead to problems at a later date. The Commission has considerable powers to halt aid that has been paid prematurely, and to require the repayment of unauthorised aid, plus interest. Notifications must be submitted through DTI's State Aid Policy Unit, in accordance with Cabinet Office guidelines.
- 19.3** A specific guidance booklet for officials on the EU state aid rules is available from the DTI's State Aid Policy Unit.

## 20 Public procurement issues

- 20.1** The vendor may need to consider the effects of setting up a PPP on public procurement and whether or not EC procurement rules apply, particularly where the business to be sold

supplies goods and services to public sector customers. Further guidance on purchasing issues, and the implications, if any, of EC or GATT purchasing obligations can be obtained from the Office of Government Commerce.

## 21 Employee issues

- 21.1** The vendor should consider carefully the handling of employee rights upon transfer. A judgement will have to be made as to whether there is a transfer of undertaking under the Transfer of Undertakings (Protection of Employment) Regulations 1981 as amended by the Trades Unions Reform and Employment Rights Act 1993. Where, as is likely to be the case, there is a transfer, the staff will transfer to the purchaser with their existing terms and conditions of employment unchanged. Pension rights are not transferred by TUPE, but Government policy towards pensions is discussed below.
- 21.2** Government policy on pensions is set out in Treasury guidance to departments on staff transfers from central Government (June 1999). This sets out the approach to be followed by Government departments, although the principles are relevant to transfers from public corporations/nationalised industries. In particular, these are that:
- staff should be offered “broadly comparable” pension arrangements for future service; and that
  - bulk transfer agreements should be provided, offering day-for-day credit for past service.
- 21.3** The guidance also states that the Government will review with representatives of employers and employees the scope for simplifying the administration of public-private partnerships, for instance by developing ‘model schemes’ or industry-wide multi-employer schemes which are broadly comparable with public service schemes and can facilitate transfers of staff between employers more easily as public - private partnership arrangements become more important to the delivery of public services.
- 21.4** It is possible for funded public sector schemes (such as the pensions schemes of the nationalised industries) to become multi-employer schemes. This allows private sector partners to become non-associated employers in the pension scheme, allowing employees transferring to the private sector to remain in the pension scheme.
- 21.5** There are potentially enormous financial effects associated with pension schemes. Failure to make a realistic assessment of the value of surpluses for example, or of the division of assets and their treatment either through the purchase price or through anticipation of their value to the new business would lead to a detrimental outcome for the taxpayer. Any surplus in the scheme should be made clear to bidders so that it may be reflected in the purchase price.
- 21.6** **Departments should take account of:**
- the need for early professional actuarial advice to protect employees and the taxpayer’s interests in the treatment of pension funds, including members’ benefits and the disposal of actuarial surpluses. The Government Actuary’s Department provide a consultancy service to departments;
  - the requirements of UK and EC Law which apply to transfers of undertakings. These are complex and departments will need to seek advice from their own legal advisers who may, if they wish, consult Legal Advisers;
  - the views of the Treasury’s Public Service Pensions Team on any undertakings on superannuation which the department is considering asking of potential purchasers;
  - the special considerations applying to terms and conditions on the transfer of civil service functions;

- Business Appointment Rules which apply to certain staff transferring from the public sector to the private sector. These rules are contained in the Civil Service Management Code. (Chapter 4, Section 4.3, Annexes A and B.)
- the potential costs of any redundancies of staff involved in transfer; and
- the need to explain developments to trade unions as the PPP arrangements progress (in addition to the consultation requirements imposed by TUPE) and to give assurances to staff. The Cabinet Office handbook “Better Quality Services” and the White Paper “Your Right to Know” (Cmnd 3818) give the general principles in this area.

## 22 Employee share schemes

- 22.1 Departments are encouraged to consider how employees may participate in the PPP. In particular, the Government is keen for employees to hold shares in their company. Offering employees shares in the PPP can also provide an incentive to improve the performance of the business both in the run up to the sale and afterwards. However, after a tradesale, there will be no liquid market in the stock and arrangements will be needed to allow employees to sell their share holdings. The company may, however, set up an Employee Share Ownership Plan (ESOP) or other arrangements to allow employees to buy and sell shares.

## 23 Vesting

- 23.1 The business to be sold is normally vested as a Companies Act company. Vesting can be the most convenient mechanism for transferring the assets and liabilities of the business to the private sector, and normally takes place as near as possible to the point of sale in order to minimise the need for interim finance and the complications that would arise if the sale were deferred. However, there have been several sales by means of transfer of assets, liabilities and employees direct to the purchaser. The advantages and disadvantages of either method should be considered by advisers and discussed as necessary with shortlisted bidders.
- 23.2 Departments should establish mechanisms to ensure post-vesting control of the business by its shareholder. Such arrangements are necessary because, under the Companies Act, the responsibilities of the company’s directors may be owed to the company itself, rather than to its shareholder (generally the Secretary of State) and because Companies Act companies do not allow for regulation by Ministers.
- 23.3 Arrangements to establish the Secretary of State’s control might take the form of control over the articles of association and/or resolutions passed at general meetings. Normally, however, the arrangements will take the form of a memorandum of understanding (MOU) signed by the board members on appointment. The provisions of an MOU will not be legally binding. The vendor will need to consider the implications of the alternative approaches in the circumstances of each case. Legal advice may be necessary.
- 23.4 Departments should also put in place a financial control regime which preserves appropriate levels of public sector control in the period between vesting and the sale. The terms of the regime should be agreed by the relevant Treasury team.

## 24 The sale competition

- 24.1 The following paragraphs consider the process of an offer of sale to a single commercial buyer or consortium (including to a MEBO team). Key stages of the sale are set out at Annex 4, but this guidance does not seek to prescribe the precise form and stages of the sale process. This will vary from case to case, depending on the circumstances of the individual sale and the nature of the demand for the business. Departments will wish to seek the views of their financial adviser on the appropriate sale strategy for a particular PPP (eg a phased sale).

**24.2** The following principles should, however, normally apply to the sale process:

- the vendor will generally maximise value for money and other policy objectives by promoting the widest possible competition, wherever practicable and consistent with the sales objectives (but see paragraph 18.3). Departments should also consider the benefits of retaining more than one preferred bidder as late as is practicable in the process to maintain effective competition and consider whether there might be an advantage in allowing bids which contain an element of deferred consideration (see section 27);
- deadlines should be set with a view to ensuring the efficient conduct of the sale and should not be so tight as to constrain the pursuit of value for money for the taxpayer;
- care should be taken to accord potential and actual bidders equality of information at each stage of the sale process, subject to the considerations in paragraph 32.2 below;
- departments must ensure that a proper record of information and advice passed to bidders is kept, so as to ensure that Government can show that all parties have been fairly treated. This may be of particular importance in a trade sale where the financial adviser may be used as the vendor's agent in discussing prices and other matters with bidders and their intermediaries.

## 25 The preparation of key information for the sale

- 25.1** Work on key sale information such as the Information Memorandum, the Long Form Report and any valuation of the business will need to be substantially completed before the tender process gets underway.
- 25.2** An Information Memorandum (IM) is issued to potential purchasers who have been selected by the vendor from initial expressions of interest (and subject to their signing a letter as described in paragraph 26.1) as a basis for bidders' indicative bids. The IM comprises a description of the entity's history and its business. A balance must be struck between providing the minimum information required to maintain the interest of potential purchasers by enabling them to form an initial valuation of the business, while not disclosing prematurely any matter which is commercially sensitive and which could be of use to a competitor. It will also be necessary to take into account any legal constraints on making information available to third parties, e.g. in license agreements. At an early stage, vendors should consider, in conjunction with their financial advisers, whether to impose an administration fee for acquisition of the IM. Potential bidders must sign a confidentiality agreement, pay an administration fee where applicable, and may then examine the IM.
- 25.3** Historical financial information must be as up to date as possible. This will involve the production of accounts up to a date falling as close as possible to the date of the Information Memorandum. Normally, the vendor will commission its accountancy adviser to prepare a Long Form Report which is made available to parties whose indicative bids have been received and before final bid stage. Those parties should also be given the chance to examine the business in more detail (the "due diligence" procedure - see paragraph 32.2).
- 25.4** The determination of what is a realistic price for the assets is best achieved by full competition and by ensuring that potential bidders have sufficient information, including a business plan and projections, to put a value on the business opportunity. However, the vendor should obtain up to date and comprehensive professional advice on the factors determining the potential value of the business before bids are received. This advice should normally include a valuation of the business, probably expressed as a range of potential values depending on the particular assumptions made. The PAC has made clear that departments must expect to be closely questioned if a pre-sale valuation is not carried out. The nature, sophistication and cost of the advice commissioned will need to be related to

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the size and complexity of the business. It will contribute to the vendor's understanding of the business, and help in marketing it to potential bidders and in negotiating the sale. It will also assist in the assessment of bids, and in considering whether the sale process and information provided to bidders has maximised available competition.

- 25.5** Valuation advice should be based on analysis of, for example, business projections, the cashflows, market and potential for growth, the potential for increased efficiency, and any alternative use of the assets. It should consider the potential value in the business for different types of trade buyer. Where there is a market in comparable businesses, this should also form part of the analysis.
- 25.6** The advice will assist the vendor in judging the level of proceeds below which the vendor would need to consider carefully whether to proceed with the sale without further marketing or other changes in approach. This may be particularly relevant where the competitive process has not produced strong competition and vendors need to consider whether the weak demand is a true reflection of the market's appetite for the business. Where there is only one credible bidder, typically a MEBO, valuation advice will be particularly important to demonstrate that value for money has been achieved in the sale.
- 25.7** The vendor should also evaluate the cost of closing the business and/or of keeping it in its current format (unless, in setting the overall policy framework, Ministers have ruled out these options having taken into account the financial consequences). However, with closure, great care should be taken with uncertainties such as the number of staff that would be made redundant, the trading profits or losses that the business might make in completing contracts in the closure period, the cost of disruption that closure would impose on clients and the full cost consequences of terminating contracts. Along with valuation advice, estimates of the costs of closure or retention will assist the vendor in assessing tender bids and in deciding whether and how best to progress the sale, having taking into account the objectives for the sale and other factors affecting the sale decision.

## 26 Warranties, indemnities, liability and confidentiality issues

- 26.1** Parties who have expressed an interest in the sale should be required to sign a letter dealing with issues of both confidentiality and liability before they are invited to proceed further. The Information Memorandum should be issued only to those parties who sign such a letter which should contain wide-ranging exclusion of liability clauses, making it clear that prospective purchasers must rely exclusively on the terms of any sale and purchase agreement. The Information Memorandum should contain a similar disclaimer.
- 26.2** The Information Memorandum need not contain a directors' responsibility statement (as a flotation prospectus will). Directors will generally, however, have a role in verifying company information in the Information Memorandum. For both legal and commercial reasons, the greatest care must be taken to ensure that all information disclosed to bidders is accurate and not misleading. Parties no longer interested should return the Information Memorandum as soon as they withdraw from bidding.
- 26.3** The case for warranties should be considered on value for money grounds. Potential warranties should be identified and considered early on in the sale process by the vendor and financial advisers. Where it is decided that best value for money will be obtained by the vendor giving certain warranties, these should be offered early on in the sale and included in the Information Memorandum, to ensure that bidders take them into account in their bids and that the vendor receives full value for them. The warranties should have specified limits as to amount and duration. The sale agreement will normally state that the purchaser is not relying on any representations or warranties other than those expressly set out in the agreement.

- 26.4** The procedures on Contingent Liabilities in Chapter 26 of Government Accounting should be followed in respect of any warranties or indemnities which are to be given.

## 27 Deferred consideration

- 27.1** It is standard practice for bids to be payable in cash at financial close. However, vendors should consider whether accepting some element of deferred consideration would increase the overall value for money achieved. They should bear in mind that deferred consideration:
- involves greater risks, for example of non-payment, and requires security arrangements to control these;
  - creates greater complexity in the bid evaluation process; and
  - does not represent a clean break between the vendor and the entity sold (for example, the vendor has to monitor the business sold to obtain early warning of factors that may compromise payment of the deferred consideration).
- 27.2** These factors may, however, be outweighed by the possibility of greater proceeds in total. If the vendor judges this to be the case and decides to allow an element of deferred consideration, this should be made clear in the Information Memorandum rather than conceded after a preferred bidder is appointed, so that competitive pressure can ensure full value is obtained.

## 28 Sale and purchase agreements

- 28.1** The vendor's legal adviser should draft the sale and purchase agreement and other legal documentation at an early stage. Draft contracts should be made available to shortlisted bidders (either during negotiations on indicative bids or at final bid stage, as the vendor judges appropriate), so that the agreement of the preferred purchaser may be secured with a minimum number of amendments in final negotiations.

## 29 Sale marketing and expressions of interest

- 29.1** A precursor to an effective competition will be to make the market aware that the sale process is in hand. The vendor should discuss the appropriate marketing strategy with its advisers (including legal advisers) and, where a series of sales is planned, should keep the effectiveness and appropriateness of the strategy under review. Depending on the nature of the business, the marketing strategy could include:
- a departmental press notice;
  - advertising the business in the national and trade press in the UK and, in appropriate cases, internationally; and
  - direct approaches by the financial adviser to appropriate commercial interests.
- 29.2** All expressions of interest, whether made known direct to the vendor, to the financial adviser, or to the managers of the business being sold, should be registered with the vendor's PPP team.
- 29.3** All communications with potential purchasers who are so registered must be on terms approved by the PPP team to ensure equal treatment of all purchasers. Normally, only general information about the business is given to enquirers at this initial stage. However,

it is becoming increasingly common for there to be a formal pre-qualification process, within which the vendor issues assessment criteria requiring each interested party to set out how it would meet those criteria. Decisions on who to include on the long list can then be made in the light of responses.

### 30 Indicative bids

- 30.1** In the light of its financial adviser's views, the vendor may compile a long list of potential bidders from the expressions of interest received in response to the marketing campaign. Potential bidders should generally be asked to sign a confidentiality undertaking before receiving further information about the business.
- 30.2** When potential bidders have received the Information Memorandum and a minimum of supplementary information as the vendor may choose to disclose, they should be invited to submit by a set date and in non-legally binding terms:
- an indicative offer (comprising the amount of the offer, and an indication of how the offer will be financed, including the bidder's reliance on bank debt);
  - details of the potential purchaser's full name, address, telephone and fax numbers, place of incorporation and principal residence, and the name and title of the principal contact;
  - any consents required to complete the purchase;
  - copies of the most recent audited accounts and current list of directors (both for the potential purchaser, and for any ultimate parent company);
  - details of the bidder's future intentions for the company which should include the main features of any business plan, including any proposals for investment or affecting employees, if only in general terms at this stage;
  - details of links with competitor companies (and, if competition issues could arise, an analysis of the monopoly power of the merged business);
  - any other details which, in the light of the objectives for the sale, the vendor may wish to take into account in assessing the bids. For example, the vendor may wish to invite bidders' proposals for employees' participation in the company; or, where there are operational properties with a significant development value, may wish to require purchasers to reflect this value in their bids; and
  - any additional information the bidder considers would help assessment of the bid by the vendor.
- 30.3** The invitation to submit indicative bids should explain the vendor's intention to proceed to detailed negotiations only on those indicative offers which are consistent with the objectives for the sale and which provide a basis for a formal offer which could have a realistic chance of success. These negotiations will precede the stage of formal bidding.
- 30.4** Where the indicative bid stage is omitted, the information needed for bidder checks can be sought along with expressions of interest. The Information Memorandum would then be the basis for firm bids.

### 31 Assessment of indicative bids

- 31.1** The criteria that will be used to assess bids should be made clear to bidders in the invitation

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to bid. A bid evaluation model should be prepared based on those assessment criteria before the final bid deadline and preferably before bids are invited. This will facilitate a rigorous bid assessment process and provide a means of evaluating bids that is rational and robust against the risk of legal challenge from losing bidders. It should also indicate the factors that need to be addressed in subsequent negotiations. The model would be expected to consider factors including:

- an assessment of the bidder's ability to perform key obligations;
- the bidder's track record and the bidder structure and relationship between consortium members;
- financial terms and risk share of the bid;
- the economic benefits or costs accruing to consumers;
- quality of the business plan;
- resource commitment, both financial commitment and strength and human resources;
- an assessment of the more subjective factors such as commitment to the aims of the PPP;
- an assessment of changes to the contract requested by the bidder; and
- qualitative criteria, including any factors over which the vendor is not prepared to negotiate.

- 31.2** If any bidder misinterprets the information in the memorandum, or supplies material which is unclear, incomplete or requires further amplification, this should be noted for exploration in the subsequent negotiations. The vendor should also seek to eliminate as many conditions as possible from competing bids at all stages of the bidding process.
- 31.3** Any novel financing plans proposed should be assessed on merits. In so far as any additional benefits flow from a material difference in tax treatment, departments should ensure that the interests of the Exchequer are recognised, and that the bid is assessed in terms of the overall return to the taxpayer, whether through sales proceeds or tax revenue.
- 31.4** Departments should identify any pre-transfer liabilities, making these clear to bidders at an early stage. In cases where material uncertainty remains, departments need to form a view on the size of any potential liabilities, and whether to retain them before accepting a sale price reduction.
- 31.5** Departments should pay close attention to the importance of selecting a shortlist of bidders which maximises competitive tension throughout all stages of the bidding process.
- 31.6** It is important that potential purchasers make clear their proposals for pension arrangements at an early stage as a degree of negotiation is inevitable.

## 32 Negotiating on indicative bids

- 32.1** Having shortlisted a range of indicative bids (where the strength of the competition makes this appropriate), the vendor and its financial adviser will proceed to negotiations with bidders.
- 32.2** This negotiating process will involve:

## Due diligence

- (i) the release of further, detailed information about the business to potential bidders in a controlled fashion. This information - which will normally include the Long Form Report - will normally be held in one or more data rooms controlled by the vendor or its advisers. Potential bidders would be able to visit the data rooms but would not be able to remove information. Potential third party purchasers, or their advisers, may also wish to visit the business, see assets, or undertake direct discussions with the management (perhaps over future employment intentions). Vendors should consider whether such visits would be appropriate but will normally wish to consider some access. The information disclosed during the due diligence process should be as complete as possible to minimise the chances of any new issues coming to light once a preferred bidder has been chosen. Visits to the business and other contacts should be rigorously controlled by the vendor's representatives (including their advisers) to ensure that potential purchasers receive a true and fair view of the nature of the business and its prospects. It will be inappropriate for management (who may themselves be potential bidders) to control the flow of information about the viability or prospects of the business;
- (ii) the need to ensure equality of information for all potential bidders. The vendor may decide not to answer questions of a material nature from potential bidders immediately but to issue a written reply, circulated to other potential bidders. Careful consideration should also be given to how much information about the business's plans and prospects should be disclosed to bidders. Clearly, the MEBO team has an inherent advantage in this respect since it knows the business more intimately than an outside purchaser. But the vendor may, for example, decide not to provide disaggregated profitability information where this may prove valuable to a competitor or damaging if misused, and where aggregate profitability figures should prove adequate for purchasers;
- (iii) where relevant, the vendor will need to consider with its financial advisers how to deal with the problem of any bidders who are potential future competitors having access to commercially sensitive information.

### The vendor will also:

- (iv) communicate to indicative bidders the weaknesses of the indicative bid and the information to be reflected in formal bid documents. Formal bids will need to cover much the same issues as were covered in the indicative bids but may require expansion and modification where an indicative bid was incomplete or unsatisfactory;
- (v) maximise pricing in the light of the leverage offered by the competition at this stage; and
- (vi) secure bidders' agreement to the terms of the draft contractual documentation for the sale. Vendors should consider securing bidders' agreement to the draft sale agreements as early as possible in the sale, by maximising the leverage offered by the competition at this stage, with the aim of minimising bidders' amendments to the draft documentation.

## 33 Formal bidding

- 33.1** When negotiations on indicative bids are substantially complete, the vendor should decide, taking account of the views of its financial adviser, whether further to shortlist bidders at this stage. Subject to that decision, an invitation should be issued to bidders to submit final bids, or to take part in more than one further round of bidding.

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- 33.2** The invitation should give any further information on the business which the vendor considers necessary.
- 33.3** Final bidders should be invited to confirm their acceptance of the sale and purchase agreements so that completion may follow as soon as possible after the final negotiation stage.
- 33.4** Final bids should remain valid for a pre-determined period (perhaps 60 days) in order to allow sufficient time for their consideration by the vendor, and allow for any adjustments should these be necessary.
- 33.5** Vendors should consider offering formal feedback to unsuccessful bidders unless there are overwhelming reasons why this should not be done (eg if a vendor's negotiating position could be weakened).

### 34 Checks on bidders

- 34.1** Vendors should consider whether to undertake checks on bidders' credentials. The stage at which, and the extent to which, these checks are undertaken will vary according to the sale exercise, but should in any event take place before a preferred bidder is selected. It is for the vendor, in conjunction with advisers, to decide what checks they wish to undertake. Some checks will attract an administrative charge and may take a number of weeks to undertake.
- 34.2** Some suggested contact points for bidder checks appear at Annex 1, in addition to the various other departmental contact points and sources of commercial intelligence (eg from online databases, internet, business periodicals, professional and accreditation bodies etc) which can supplement information already obtained to provide a wider profile of a bidder. Further information about the sort of data held by the directorates and agencies can be obtained by reference to the contact points in Annex 1.

### 35 Final negotiations with preferred bidder(s)

- 35.1** Final bids should be considered by the vendor in the light of advice from its financial adviser, and recommendations made to Ministers on the preferred purchaser or, preferably, purchasers where the strength of the competition gives the vendor this option.
- 35.2** Following a decision on one or more preferred bidder, the vendor should seek to complete the sale as soon as possible. The vendor should use any leverage presented by the retention of more than one preferred bidder to negotiate to maximise the sale proceeds.
- 35.3** The vendor should carefully weigh the advantages and disadvantages of continuing final negotiations with all close final bidders before entering exclusive negotiations with a preferred bidder, keeping the relevant Treasury team in touch as appropriate. The key is to resolve as many commercial issues as possible before that point is reached.
- 35.4** A single preferred purchaser may seek to exploit any period of exclusive negotiation on the contractual terms so as to reduce the consideration paid, if new factors affecting the business (eg litigation pending) are brought to light during a period of further delay. In these circumstances, the vendor's best protection will lie in ensuring that:
- satisfactory disclosure of the prospects of the business has been made before final bids are submitted;
  - the contractual terms have been fully discussed at an earlier stage;

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- unsuccessful bids remain on the table while final negotiations with any preferred bidder take place; and
  - the period of any exclusive negotiation is as short as possible.
- 35.5** However, great care should be taken not to infringe EC Procurement Law when adopting an approach which involves one or more “reserve bidders” being brought back into play following negotiations with the first choice preferred bidder.
- 35.6** Where the vendor forgoes proceeds in recognition of a bidder’s concerns about the financial impact of potential changes after a sale, they should consider putting in place arrangements to claw back the amount foregone if the bidder’s concerns remain unrealised.

### 36 Completion of sale

- 36.1** Unless any prior conditions remain to be fulfilled (eg to satisfy external regulatory requirements), the trade sale is completed upon the signature by both parties of the sale and purchase agreements, and upon the payment of consideration for the acquisition of the business.

## ANNEX 1

## LIST OF USEFUL CONTACTS

**General Policy on PPPs**

Peter Schofield  
 HM Treasury  
 Allington Towers  
 19 Allington Street  
 LONDON SW1E 5EB 020 7270 4640

**Accountancy advice on PPPs**

Tracy Gordon  
 Central Accountancy Team  
 H M Treasury  
 Allington Towers  
 19 Allington Street  
 LONDON SW1E 5EB 020 7270 4538

**EC Services Directive/Procurement Policy**

Mike Davis  
 Office of Government Commerce  
 2-6 Salisbury Square  
 LONDON EC4Y 8AE 020 7211 1332

**Competition Policy**

Jeremy Straker  
 CP3A, Room 619  
 Department of Trade and Industry  
 1 Victoria Street  
 LONDON SW 1 H OET 020 7215 6814

**EC State Aid**

Ann Turner  
 Department of Trade and Industry  
 Kingsgate House  
 Room 203  
 66-74 Victoria Street  
 LONDON SW1E 6SW 020 7215 4712

**General Contract Issues**

Central Unit on Procurement  
 Office of Government Commerce  
 2-6 Salisbury Square  
 LONDON EC1Y 8AE 020 7211 1300

**Access for NAO**

Lorraine Constable  
 Treasury Officer of Accounts  
 HM Treasury  
 Allington Towers  
 19 Allington Street  
 LONDON SW1E 5EB 020 7270 5361

**Pensions Issues**

Peter Hall  
 Public Service Pensions  
 HM Treasury  
 Parliament Street  
 LONDON SW1P 3AG 020 7270 5896

**Legal Adviser Issues**

Elizabeth Hambley  
 Treasury Legal Advisers  
 Office of Government Commerce  
 2-6 Salisbury Square  
 LONDON EC4Y 8AE 020 7211 1380

**Legal Aspects of TUPE**

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## ANNEX 2

### MANAGEMENT AND EMPLOYEE BUYOUT (MEBO)

- 1 A MEBO normally comprises a new, private sector company bidding in competition with other companies to purchase the business as a single commercial operation. The main difference is that the public sector managers and employees of the yet to be sold business are substantial shareholders in the new company. The remainder of the equity and debt finance is usually provided by a consortium of financial institutions sometimes including commercial or other interests – which is prepared to back the managers’ commercial judgement about the future prospects of the business. The MEBO need not actually be a company at the bidding stage, especially if a financial backer is bidding on its behalf.
- 2 The great strength of a MEBO is its knowledge of the business and the incentive placed on managers and employees to run the business efficiently so as to service and repay commercial debt, and to pay a dividend on their equity stake. Conversely, weaknesses may be a MEBO’s lack of commercial management expertise and of financial strength in depth - factors which may make it difficult for the team to attract, and to service in the longer term, adequate financing arrangements for their bid. A MEBO bid may also generate conflicts of interest. Management will have less time to devote to running the business and it might have an incentive to depress the performance and value of the business to lower the level of competing bids (see paragraph 2.1 of this annex). The vendor needs to weigh up these factors, and the objective to encourage wider employee participation, in considering whether to allow a MEBO bid.
- 3 Where the business provides a service to Government but has very few capital assets, the responsible department’s approach may be to outsource (or contractorise) the service rather than to sell by trade sale. However, the difference between a trade sale and an outsourcing exercise may not always be clear cut. If, as a firm outsourcing strategy develops, it is decided to transfer significant assets (eg accommodation and equipment) to the new private sector supplier, the handling of the competitive exercise and any MEBO proposal to bid for those assets and the service contract will, for reasons of value of money and propriety, be the same as for a trade sale.
- 4 A MEBO can arise as a result of a management initiative rather than in response to an announced competition exercise. In this event, the management team would need to prepare a robust business plan to support such an initiative. The department should consider whether or not it would be prepared to entertain a MEBO bid, taking account in particular of the factors in paragraphs 1.2, 2.2 and 2.3 of this Annex. The department’s decision should be made clear at the outset.

### Propriety and control issues raised by a MEBO bid

- 5 Given managers’ and employees’ unique understanding of the commercial operations and prospects of the business, departments must ensure that the business is managed in a proper, objective manner in the run up to the sale; that it is not allowed to under-perform so as artificially to depress the sale price; and that other potential purchasers of the business compete on fair terms. Draft guidelines for issue by the vendor to potential MEBO participants are attached at Annex 3.
- 6 MEBOs may raise particular questions of conflict of interest for the individual staff involved. Departments should require any staff considering whether to participate in a

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MEBO to declare this as early as possible. If a conflict of interest should arise, the department may need to withhold or withdraw its approval of participation in the MEBO by the individual concerned, or take steps to resolve the conflict of interest in some other way.

- 7 In considering possible conflicts of interest, departments should also take into account the principles in the Business Appointment Rules. Before they agree to a MEBO bid they will want to make sure that there are no grounds for criticism that commercial trade secrets are at risk, or for other public perception concerns. In some circumstances, staff who transfer to the private sector following a successful MEBO bid may be required to apply for permission under the Rules to take up their new posts. The Rules are set out in the Civil Service Management Code, Chapter 4.3 Annexes A and B.

### Rules for competition

- 8 The normal presumption is that the MEBO should compete on all fours with other bidders so that the vendor can identify the best possible bid. Departments are advised to enforce this discipline strictly to ensure value for money, and to avoid judicial review.
- 9 In a number of sales, Ministers have agreed, other things being equal, to give small price preference to a MEBO team where this is consistent with their objectives for the sale. This may be construed as State Aid (see 19.1 in main text). However, as MEBO bids are now better established, there may be less of a case for any price preference.
- 10 Where a price preference is offered, the onus will remain on the MEBO team to demonstrate that its bid is the most competitive against any other criteria to which the vendor may have regard in assessing the bids; for example, the financial robustness of the bidder and its future plans for the business. Departments need to make a case to the relevant Treasury team if they wish to offer a price preference to a MEBO team.
- 11 In exceptional cases where the MEBO team is the only preferred bidder, great care should be taken to ensure a full and accurate valuation of all aspects of the business, and to derive from this a reserve price below which it would not be defensible to sell the business.

### Financial support to MEBO teams

- 12 Where the department judges that a MEBO would add to the genuine competition for the sale and the MEBO will further the Government's objectives for employee involvement in the PPP, public support may be offered by the vendor to the MEBO team to enable them to construct a sound business case before approaching financial institutions. However, as with price preference, the vendor may consider that there is no need to give financial support now that MEBO bids are better established. All proposals for support should be approved by the relevant Treasury team. Any incentives offered should be declared to all bidders. Departments should reclaim financial assistance from bidders who are successful.
- 13 Financial support is normally given to one MEBO team only. In the event that two or more teams emerge from within the business, they should be encouraged to combine their efforts and act as a single team, in order to enhance their ability to put forward a credible bid. Exceptionally, however it might be decided to support one team per business component, if it is intended (or if the option exists) to break up the business upon sale.
- 14 There will be a number of broad stages to the submission by the MEBO of its final bid. For example, preliminary investigation; pre-qualification for tender (including discussions

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with potential consortium members); submission of tender; and conclusion of legal/corporate finance negotiations.

- 15** Normally the vendor would not contribute towards the costs of the preliminary investigation stage. The costs of an initial feasibility study are normally small and the need to put some cash up-front helps to ensure real commitment by the MEBO team. Any financial support will not usually start before the pre-qualification stage; and should normally cease once the MEBO has found financial or commercial backers to support its bid.
- 16** Limits should normally apply at all stages; for example, to the absolute level of qualifying expenditure at each stage, and to the percentage of Government support for that expenditure. A mechanism which has been used is to provide support of around 50 per cent of the MEBO's expenditure at pre-qualification stage and progressively to reduce support at later stages.
- 17** Where a joint venture bid is proposed, the MEBO team should normally look to its prospective partner(s) to provide support.
- 18** It should be a condition of the arrangements that, if the MEBO is successful in the competition, any public support will be repaid as an expense of the acquisition. The support need not be repaid, however, if the MEBO bid is unsuccessful.
- 19** The costs of any financial assistance for MEBOs should be borne by the sponsor department.

## ANNEX 3

### DRAFT RULES AND PROCEDURES FOR ISSUE BY THE VENDOR TO POTENTIAL MEBO PARTICIPANTS

(These will require adaptation according to the circumstances of a particular sale)

#### RULES AND PROCEDURES FOR MANAGEMENT AND EMPLOYEE BUYOUT

- 1 The period during the run up to the sale of [Company] may give rise to conflicts of interest for/on the part of [Company] management and staff. This potential is increased when management and employees are involved in a Management and Employee Buyout (MEBO) or consortium.
- 2 The [Department] and its Principal Accounting Officer have a duty to ensure that:
  - [Company] continues to be managed in an efficient and effective manner prior to the sale;
  - all bidders for [Company] compete on as equal a basis as is reasonably possible, and that the bids can be assessed on level terms against the selection criteria;
  - the potential for conflicts of interest is reduced to a minimum.
- 3 In carrying out this duty it is necessary for the [Department] to introduce rules and procedures for [Company] management and staff who are, or may be contemplating, participating in a MEBO between now and the sale of [Company]. The rules and procedures for these parties (the participants) are set out in the following paragraphs, and should be read in conjunction with the paper on project organisation, which sets out the framework for separating the sale of [Company] from its day to day management. The rules and procedures may be changed from time to time in the light of experience.
- 4 It shall be the responsibility of [named MEBO leader] to ensure that all managers and staff who are or who may be involved in a MEBO are aware of the rules and agree to observe them.

#### Running The Business

- 5 During the preparation for the sale:
  - each participant's primary duty will continue to be to carry out their normal duties in the most efficient and effective manner in accordance with [the Framework Document and] agreed plans, budgets and existing financial controls;
  - no action should be taken or omitted that would give any competitive advantage to a management consortium over other bidders, nor that would in any way suppress the value of the business or its attractiveness to other bidders;
  - each participant will continue to have a duty of loyalty and confidentiality to their employer, [Department];
  - normal terms and conditions of employment will continue to apply. Conditioned hours are still to be applied to the management running [Company], and any work carried out

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in preparing for a consortium bid should be done outside of those hours, except where agreed by the [Department]. (See also Financial Support below);

- during the sale process, managers should be available as necessary to participate in presentations to potential purchasers;
- if any participant is concerned about conflicts of interest, for the business or for themselves personally, these should be raised with [named Departmental official].

### Contact with Consortium Participants

**6** Potential participants in a MEBO should ensure that:

- all proposed contact with potential or actual participants in the management consortium is notified to the vendor's PPP team. [Department's] Financial Advisers in the sale will attend as independent observers at all meetings between potential and actual participants in the consortium, to ensure fair play;
- no contact is made with potential third party members of a management consortium, to discuss the sale of [Company] until after the [Department's] Financial Advisers are in place;
- if it is necessary to contact a business or financial institution in the normal course of [Company's] activities, and that business or financial institution is a potential member of the management consortium, then any discussion or correspondence is confined to the normal activity. No discussions or correspondence should be entered into on the sale of [Company], other than under the conditions set out in these rules;
- their status is clear to any third parties. That is, that participants in any MEBO are not, as such, authorised to act as agents of [Company] and are not acting in the course of their employment.

### Contact with Potential Purchasers

**7** Other potential purchasers will be in direct competition with the consortium. It is crucial, in order to create a fair competition, that each potential purchaser is treated in the same way:

- any request from other bidders (or their advisers), where known as such to [Company] for discussions (including telephone discussions) with the [Company] management, or for visits to the Company premises, shall be reported promptly to the [Departmental contact]. Such discussions or visits shall take place only with the express prior approval of the [Department], and a person nominated by the [Department] shall be present during them;
- any contact with a potential purchaser in the normal course of [Company's] activities will be subject to the same rules as for contact with a potential consortium member.

### Status of the Consortium

**8** No MEBO participant or member of the consortium may do or say anything which could convey the impression that the [Department] will give it preferred bidder status.

## Release of Information

- 9** In the course of the sale preparations, MEBO participants in their role as managers will be expected to play a full role in the provision and verification of information in the Business Plan, Information Memorandum and, if required, the Long Form Report, and co-operate fully in the provision of full and accurate information on [Company], as required by the [Department's] Financial Advisers to the sale, and other members of the PPP team.
- 10** In addition, participants will be expected to comply with the following guidelines where references to information are as follows:
- (i) information about [Company] which is already in the public domain, or which could be obtained from a public source by any interested party;
  - (ii) unpublished information means information prepared by [Company] employees, whether Participants or not, in their capacity as [Company] employees, or information to which they have access in this capacity;
  - (iii) private information means any information, or any analysis or opinion in relation to unpublished information, which Participants have prepared solely in their capacity as members of the consortium;
  - (iv) before publication of an Information Memorandum, Participants must not (and must endeavour to ensure that employees of [Company] who are not MEBO Participants do not) give any unpublished information relating to [Company] to their advisers, or to other members or potential members of the consortium (or their advisers);
  - (v) at all times, any information relating to [Company] which Participants give to their advisers, or to other members or potential members of the consortium (or their advisers) must be relayed at the same time to the [Project Team/Financial Adviser];
  - (vi) any unpublished information which Participants have made available to their advisers or to other members or potential members of the consortium (or their advisers) may be given equally by the [Department] to all other prospective bidders who have signed the appropriate confidentiality undertaking;
- 11** It is not the intention that any private information shall be given to any other bidder. Where the [Department] considers that it might be appropriate or necessary to give private information to other bidders, they will first advise the senior Participants of their intention.

## Confidentiality

- 12** The following rules will apply with regard to issues of confidentiality:
- up to any submission of a bid by the consortium, members may disclose to, or discuss with, the media or other employees of [Company] the existence of, or the affairs of, the MEBO. But any disclosure or discussion relating to the sale process generally and any disclosure to the media about [Company's] business may take place only with the prior consent of the [Department];
  - once bids have been received, all bidders will be bound by the same rules of confidentiality. It is envisaged that these will include a prohibition on disclosing or commenting on the existence of, or details of, a bid;

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- 13 The senior Participants shall ensure that all members of any consortium, and all their financial and professional advisers are aware of the rules, and acknowledge in writing to the [Department] that they are under a general obligation to comply with these rules.
  - 14 All Participants and members of the consortium shall be required to sign a confidentiality agreement prepared by the [Department].

### Advisers to the Consortium

- 15 No advisers appointed to advise the [Department] may be appointed to advise any consortium. The [Department] undertakes to give the senior Participants a list of all advisers currently appointed. The consortium shall inform the [Department] of the names of all advisers which they propose to invite to bid to advise the consortium. The [Department] will consider whether any conflicts of interest might arise.

### Financial Support and use of [Company] Resources

- 16 Management participation in a consortium bid requires a great deal of commitment on the part of those managers involved, if it is to be a success. That commitment is expected to involve some financial commitment from an early stage:
  - the [Department] will not be prepared to consider direct financial support towards the development of a bid from a consortium involving an outside company, but may be prepared to consider limited assistance through the use of the Department's resource (e.g. managers' own time as employees);
  - for the avoidance of any doubt no part of the fees or expenses of any advisers appointed to advise the consortium may be paid, directly or indirectly by the [Department];
  - participants must not, in their capacity as members of any MEBO team, use any [Company] letterhead.]

### Accounting Officer

- 17 As [Agency] Accounting Officer, the [Chief Executive] remains accountable for the current activity of [Company].

### Internal Audit

- 18 The PPP team may invite the [Department's] internal Audit to investigate specific aspects of the sale process and to report to the team.

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## ANNEX 4

### A CHECKLIST OF THE KEY STAGES IN A TRADE SALE

These are intended to be indicative only. The precise ordering of events will vary according to the circumstances of each sale.

1. Define the business to be sold.
2. Feasibility study.
3. Decision in principle and formulation of objectives, including performance obligations on the PPP.
4. Announcement of sale\* (probably via arranged PQ and/or press notice). Vendors should not be specific about timing, as announcing a date for sale risks giving bidders an advantage in final negotiations.
5. Prepare business for sale, eg rationalise and restructure; consider legislation and relevant regulations; set financial accounting arrangements on commercial footing.
6. Obtain voted funds to cover costs of sale if not already available.
7. Appointment of advisers.
8. Prepare offer for sale document and information memorandum.
9. Advertise the business (including in the Official Journal of European Communities) inviting expressions of interest.
10. Announcements at all key stages to unions and employees in accordance with TUPE requirements and Treasury guidance on pensions.
11. Indicative bids invited and assessed. Shortlisted candidates examine financial information, and carry out due diligence, comment on sale and purchase agreements, and submit final bids.
12. Assess final bids from private sector (and MEBO team).
13. Negotiation with favoured bidder.
14. Establish the business as a Government-owned Companies Act Company and transfer staff into it (the appropriate timing will vary from case to case).
15. Control arrangements in place between exchange of contracts and sale completion.
16. Implement disengagement procedures.
17. Completion of sale.
18. Prepare documentation for likely NAO meeting after sale.

\* and other stages later on as appropriate.

