

## **Procedure for Cure of a Key Business Unit (KBU) Failure to Achieve Bid Terms Under a Managed Competition Agreement**

### Policy Background:

The goal of the City's managed competition program is to provide the best service at the lowest cost. Private sector interest in competition must be maintained by ensuring a level playing field from the initial bidding process throughout the term of the contract.

When a KBU of the City wins a bid competition, the City assumes two roles. In one role, the City acts as a purchaser of services. In this context, the parties enter into a contractual-type relationship where the KBU agrees to perform and the City agrees to pay for performance. With respect to performance standards, this relationship warrants the same terms that would apply if the City were dealing with a private business. However, the fact that the KBU and the City are the same legal entity requires the addition of certain clauses, including notice of default. It also requires the deletion of certain clauses, such as provisions for performance bonds, insurance, injunctive relief, jurisdiction, and venue.

In its second role, the City manages the KBU as a division of the City and bears responsibility for payment of the KBU's costs. This relationship is analogous to that of a corporate division and corporate headquarters. Decisions regarding corrective action when a KBU overruns its sealed bid amount fall within the bounds of business judgment rather than contract law. However, it is important that all parties understand the factors that impact these decisions, as well as the potential alternative courses of action.

In either role, the decision-driving factor is the long-term best interests of the taxpayers.

### Memorandum of Understanding (MOU):

When a KBU is awarded a service contract as a result of a managed competition, a MOU is executed between the KBU and the City. The MOU serves as a contract that incorporates the terms of the Request for Proposal (RFP) and the KBU proposal.

### Internal Audit:

It is the role of Internal Audit to ensure that the provisions of a MOU are met by a KBU. Audits will review both financial and service standards performance. The MOU will stipulate the audit periods and, if applicable, the times when gainsharing will be calculated.

For each performance period, Internal Audit will submit an audit report to the City Manager and the KBU indicating the degree of financial and service performance as stipulated by the MOU.

### Nonperformance for Audit Period:

Should an audit report for any quarterly or semi-annual audit indicate financial or service nonperformance, a written report indicating corrective actions to be taken and target completion dates should be prepared by the KBU and presented to Internal Audit and the City Manager within fifteen days of receiving the audit report. The KBU will present to Internal Audit a written update on its progress no later than 90 days following the initial report.

### Nonperformance for Contract Year:

Should a contract year-end audit report reveal financial or service nonperformance, the KBU will be given the opportunity to cure the deficiencies. A written "Plan for Cure" will be prepared by the KBU and presented to the City Manager within thirty days of the year-end audit that will include:

- Reasons for the nonperformance
- Measures to be taken to correct deficiencies
- A schedule that will lead to the timely conformance with financial or service requirements

The City Manager, with input from Internal Audit, will determine if the "Plan for Cure" is sufficient to address the deficiencies. Should the plan be approved, periodic audit reports will determine if KBU performance meets the goals of the plan. Should the plan be deemed insufficient, the City Manager may direct revision of the plan. However, if the deficiencies are so great that successful performance cannot be reasonably expected, the City Manager may take action consistent with section "Inability to Cure."

### Inability to Cure:

In the event that the "Plan for Cure" is not successfully met the City Manager may take any actions she deems appropriate, including:

1. Terminate the contract;
2. Recover deficits from accrued retained earnings generated in prior years (i.e., the 50 percent City share);
3. Carry forward and Recover deficits from future retained earnings and gainsharing;
4. Continue under a revised MOU;
5. Disallow the KBU from bidding on a future services competition;
6. Impose mandatory spending limits;

7. Require a deficit to be added to future bids; and
8. Suspend gainsharing.

Factors Impacting the Appropriate Remedy:

Some of the factors that would impact the City's decision on how to address an inability to cure may include:

1. The severity of the breach;
2. Past performance under the MOU (whether it has been generally acceptable or unacceptable, and whether the KBU has demonstrated an ability to resolve problems);
3. The cause of the breach, and whether it has been adequately addressed;
4. Whether the cure plan is comprehensive and realistic;
5. Past cure attempts;
6. The availability of substitute service providers;
7. The cost difference between what the KBU can realistically provide the service for and the price offered by the next lowest bidder, taking into consideration the time of the last bid;
8. The costs of transition from the KBU to another service provider;
9. Current Market Conditions;
10. The cost of the KBU re-entering the business at a future date, and whether the elimination of the KBU as a performer of the service will have a long term detrimental effect on competition and the City's ability to obtain the service at the lowest cost;
11. The year of the MOU in which the breach occurs;
12. Whether the cause of the deficit was foreseeable;
13. Whether the deficit was attributable to a lack of experience in forecasting costs for purposes of managed competition; and
14. Other factors which may impact the long-term best interests of the taxpayers.

As with all decisions, the over-riding consideration is what result will achieve the best service for taxpayers at the lowest cost over the long run.

Change Orders:

While not encouraged, a KBU may be entitled to a change order if the City materially changes the nature or scope of work to be performed or if uncontrollable circumstances (i.e. fire, flood, etc.) impact the ability to perform.

Change orders should be timely prepared with sufficient documentation so that they may be examined by Internal Audit prior to being presented to the City Manager for her consideration.