Pay for Performance

The Pay-for-Performance Public/Private Partnership

The Win-Win Scenario

By Robert S. Cohen

The Pantry, Inc. (d.b.a. Kangaroo Stores and various other names) was faced with serious financial exposure resulting from the acquisition of a large chain of Florida convenience stores—a self-insurance obligation on 70 LUST sites with potential liability in the millions of dollars. The first $150,000 or $300,000 of cleanup liability for petroleum contamination was covered by the Florida Trust Fund, but the remaining of the $1,000,000 federal financial responsibility obligation per site was covered by a self-insurance pool. The average cleanup cost in Florida is well in excess of $300,000.

The problem: How could The Pantry control costs, ensure prompt cleanups, and use the trust fund contribution in the most efficient manner?

The solution: Use pay for performance [1] (PFP) at these sites, and use competitive bidding techniques to establish the lowest market price in a cooperative effort among The Pantry, the Florida Department of Environmental Protection (DEP), and carefully selected consultants.

Let's look at the circumstances leading up to the partnership, the controversial regulatory issues, the process, and the results. It is important to note that although this partnership was specific for Florida, the concept can work in most jurisdictions.

The Problem

The Florida State Legislature decided to phase out the trust fund as a financial assurance mechanism. Beginning in 1996, the coverage was reduced to $300,000 per incident, then to $150,000 per incident, and finally entirely phased out by December 31, 1998. In order to meet federal financial responsibility requirements (40CFR 280), The Pantry set up a self-insurance fund to cover the difference between the trust fund cap and $1,000,000.

The Pantry owns or operates approximately 500 convenience store/gasoline stations in Florida and manages remedial or assessment activities on 400 sites with reported discharges (some no longer in operation). Seventy sites had trust fund caps of $300,000 or $150,000.

If The Pantry chose to follow the normal pathway, DEP would have preapproved assessment and remedial activities and paid the costs (after a $10,000 deductible) up to the $150,000/$300,000 limits. After the limit was reached, The Pantry would have to pay 100 percent of all cleanup costs with no limits. With average cleanup costs well in excess of $300,000, The Pantry was quite concerned about the potential liability and the cost of maintaining significant environmental reserves on the balance sheet to cover this liability.

The Solution

The Pantry's solution was to use PFP and competitive bidding to minimize the amount it would have to pay above the $150,000/$300,000 from the trust fund. Data demonstrate that PFP produces less expensive, faster cleanups with guaranteed environmental results. When PFP cleanups are priced by market-based bidding among cleanup consultants, the price for final cleanup is dramatically reduced.

The Pantry decided to set a maximum price for cleaning up each site, using competitive bidding in a PFP approach. The Pantry invited qualified cleanup contractors to bid the price of cleanup beyond the $150,000 or $300,000 maximum state fund coverage for a bundle of sites. The thirty-five $150,000-limit sites and the thirty-five $300,000-limit sites were to be awarded as two "bundles" — as two multi-site PFP cleanup contracts to the winning contractor. The Pantry released its request for proposal (RFP) to prequalified consultants for the two bundles of sites.

After the RFP was released, the respondents had two weeks to review The Pantry's and DEP's files and identify any sites that did not have sufficient assessment data to estimate the site's total cleanup cost. Some assessment work had been completed at most of the sites. A few sites had remediation systems in place.

Eleven consultants responded to the RFP. Upon review of the data, each consultant suggested, in order of priority, sites where more data was needed so as to price confidently. The Pantry then retained an independent consultant to do Phase II-type investigations to collect additional data on 17 sites and provide the data and maps to the bidders. The consultants then submitted sealed proposals with a formal bid opening.

The bids were evaluated on three considerations and rated on a scale of 100 points:

1. 50 points—lowest bid for total dollar above trust fund cap
2. 25 points—qualifications and experience
3. 25 points—financial mechanism or guarantee to assure completion of contract for cleanup.

Results

The respondents to the RFP actually submitted two bids: (1) 35 sites with a $150,000 cap and (2) 35 sites with a $300,000 cap. The range in bids was quite typical of the experience of various PFP bidding projects conducted in several states. The high bid for the $300,000-cap sites was $3,350,000 with several low bids of zero over the

■ *continued on page 24*

■ **PFP** *from page 23*

trust fund limit. The high bid for the $150,000-cap sites was $5,500,000 with a low bid of $100,000 over the trust fund limit. Half the consultants bid zero or less (i.e., at or below the $300,000 trust fund coverage on the $300,000 cap sites). Note: the consultant was required to supply the cost estimate for each site, though only the total bid over the cap [for the bundle of sites] counted for the scoring of the RFP.

The eleven bids were evaluated, and three finalists were selected. All finalists participated in an oral presentation, which consisted of answering one question: "Since the average cost of cleanup is historically greater than $300,000, how will you implement cost savings to meet your bid?"

Working in Partnership to Resolve Regulatory Issues

There were complex legal and administrative obstacles to The Pantry's planned RFP process for selecting consultants and setting PFP cleanup prices. These were resolved via a working partnership between The Pantry and DEP.

An obstacle was found in the Florida statute's prohibition against remuneration from the consultant to the responsible party for the privilege of assigning sites. Since The Pantry had many sites with varying caps—$150,000 to $1,000,000+—it had to avoid assigning high-cap sites to a consultant in turn for the consultant taking a loss on low-cap sites. Therefore, The Pantry's RFP was set up to be independent of any other consulting relationship. The $150,000 and $300,000 sites were judged independently to prevent any appearance that the $300,000 sites were supplementing the $150,000 sites. The DEP actively observed The Pantry's bidding process to assure compliance with statute.

Another issue of concern was the relationship between the responsible party (The Pantry, Inc.) and the DEP. Though the consultants were assuring The Pantry of a maximum total cost, the DEP was going to pay the bills up to the state-fund cap. Thus the state considered each site to be an entirely independent project with its own funding limit. The Pantry intended to bank its awarded bid amount and provide that dollar amount to the consultant on any site that went over its state-fund cap. In this way, the consultant had the freedom to negotiate the cleanup cost with DEP using The Pantry's funds when required.

Although The Pantry solicited bids, the Florida program sets prices by negotiating. The Pantry bid set the maximum price for a set of sites; however, the consultant had to negotiate each site with the DEP, as each site has a separate trust-fund limit. As discussed below, PFP bundling techniques allow the consultant to negotiate with DEP a group of sites at a total fixed price; a specific price is then assigned to each site.

Analysis

The range of bids was both remarkable and expected. Remarkable was the large spread of cleanup prices for very typical sites. With 10 years of historical data we would expect a much smaller spread. On the other hand, we expected that cleanup costs would vary considerably based on the efficiency of the consultants. On any individual site there may be a considerable margin of error in estimating costs. For a collection of sites, the total cleanup cost can be estimated accurately, even without complete assessments. The RFP data suggest several conclusions (see Figures 1 and 2 [2]):

- Cleanup costs can be reasonably estimated for a bundle of sites, even without thorough assessment data;
- Some consultants are consistently and considerably more expensive than others;
- Competitive bidding of bundles of sites can result in substantial savings while maintaining desired environmental goals and timetables; and
- The average cost of a cleanup per site is significantly reduced by competitive bidding.

What distinguishes the consultants' approach from the high bid to the low bid? The low-bid consultants leverage the "volume discount" by managing their work and resources more effectively across all 35 sites. Due to the nature of the trust funds, consultants typically treat each site as an individual project in all regards. There is little motivation to manage the projects using volume discount techniques such as:

- Reusable skid-mounted remediation equipment;
- Top quality remediation equipment that will have a useful life span for several sites; and
- Coordinated mobilization at many sites.

The most effective way for the consultant to take advantage of the volume discount is to bundle sites together for negotiating PFP agreements. Negotiating many sites as a bundle has several distinct business advantages:

- Much faster negotiations;
- Spreading of risk among a group of sites;
- Introduction of innovative technology without having to prove efficiency (though safety must always be demonstrated beforehand); and
- Considerably reduced paperwork and time to obtain DEP preapproval of costs.

One consultant took a particularly innovative approach in pricing sites. He won a majority of the $300,000 sites and proposed to DEP to clean up all sites at a fixed price per site. The fixed price is determined simply by the contamination level as related to the cleanup target. For example, the highest cost per site is $175,000 for contamination consider-

Figure 1

RANGE OF BIDS ABOVE CAP

$150K	$300K
$0.00	$0.00
$146,996.35	$0.00
$147,168.08	$0.00
$383,325.83	$0.00
$400,000.00	$0.00
$589,141.95	$0.00
$827,700.94	$0.00
$837,011.63	$160,369.50
$947,525.59	$218,442.98
$1,523,950.94	$289,922.97
$5,498,239.90	$3,357,092.22

ably above targets, while the fixed costs for monitor-only sites is about $115,000 for five years of natural attenuation monitoring.

Winners and Losers

Who won?

It seems that just about everyone did.

- The Pantry saved $2 million to $3 million dollars in self-insured (above cap) cleanup costs.
- DEP's cleanup costs will be at levels considerably below historical averages. For the $300,000-cap sites, this represents millions of dollars of anticipated savings to the department.
- Consultants obtained a large block of sites with minimal marketing effort. By using volume cost-containment methods, along with considerably reduced paperwork via PFP, the consultants are in a position to book a considerable profit.
- Citizens of Florida gained a faster and more efficient cleanup of environmental impairment.

Who lost?

Consultants who were not adept at PFP contractual techniques and not able to tightly control costs.■

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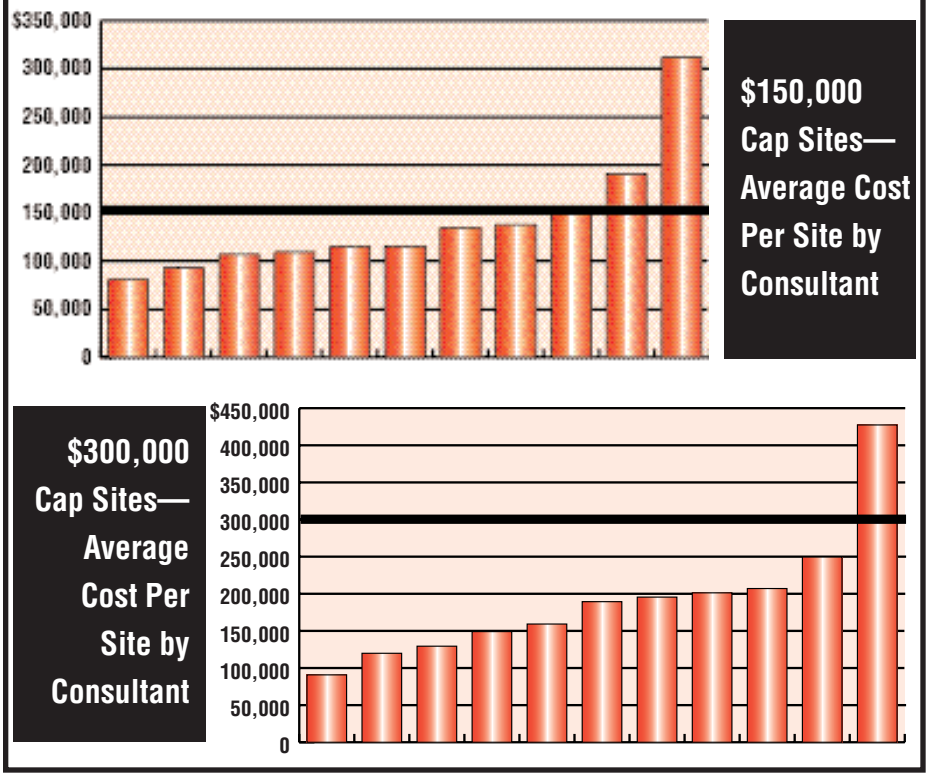
[1] Pay-for-performance is a contractual mechanism by which the cleanup consultant is paid upon achieving agreed-upon environmental milestones. The cleanups are typically faster and cheaper than the ordinary time and materials approach. PFP has been described in previous *LUSTLine* articles (see bulletins 38, 36, 34, 33, and 32), and more information is available at the EPA Web site: **http://www.epa.gov/swerust1/pfp/index.htm**

[2] Figure 1 is the consultants' bid above the cap of $300,000 or $150,000. Figure 2 is the average price for the bundle by consultant. Although the average price may be less than the cap, individual sites may be greater than the cap, resulting in a bid amount over the cap.

Figure 2



■ **Boutique Fuels** *from page 12*

year's spring transition season, while maintaining the environmental benefits needed during the summer smog season.

The second boutique fuels issue is the growing number of state and local governments that have adopted their own fuel programs that are different from the federal RFG program. EPA has identified several reasons why states have adopted their own boutique fuel requirements, including reduced cost compared with the federal RFG program, local air pollution control needs, concerns about the oxygenate mandate in the RFG program, and concerns about the use of MTBE. A number of states want to avoid the use of MTBE in their gasoline because it has been found to contaminate water supplies in some areas.

Despite the number of state and local fuel programs, EPA has found that the current gasoline production and distribution system is able to provide adequate quantities of boutique fuels, as long as there are no disruptions in the supply chain. If there is a disruption, such as a pipeline break or refinery fire, it can be difficult to provide gasoline supplies because of constraints created by these boutique fuel requirements. In addition, fuel providers are concerned that recently enacted state laws that ban the use of MTBE in future years may proliferate the number of boutique fuels and present new challenges to this country's fuel production and distribution system.

EPA staff have also prepared a white paper, "Study of Unique Gasoline Fuel Blends, Effects on Fuel Supply and Distribution and Potential Improvements" (EPA420-P-01-004), which explores a number of possible approaches that could reduce the total number of fuels in the longer term. This white paper, which will be released for public review and comment, lays the groundwork for needed future study into these and other possible approaches. ■

For more information on the "Boutique Report" and related documents, go to **www.epa.gov/otaq/whatsnew.**