

25 DEC '95 12:44 FROM

TO GRO P.02/04

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Mr Tony Oppenheim
Forest Road
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Middlesex
TW13 7EJ

5 December 1995



POH-729D

Dear Mr Oppenheim

PATHWAY'S FINANCIAL STRUCTURE

I am writing to confirm certain points arising from the meeting held yesterday on the above subject.

Charterhouse Bank, on behalf of the Programme, have reviewed Pathway's financial structure and have raised a number of serious concerns. These concerns have been registered by the Programme as a Class A Risk on the Risk Register and are summarised as follows:

Performance Risk

Pathway's credibility to be the service provider for the automation service is dependent on its three shareholders/subcontractors and other subcontractors. However, the contracting authorities' contractual relationship will be with Pathway only. Therefore, there would exist a significant risk for the contracting authorities on the efficacy of the subcontract arrangements to be put in place by Pathway.

Financial Risk

There are significant risks posed by Pathway's relatively high level of financial gearing and the comprehensive security package required by Pathway's banks. They relate to:



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- the adequacy of the finance for the initial capital investment;
- the availability of adequate finance later in the contract life.

Charterhouse highlight that:

- Pathway's shareholders will have no commitment to provide additional equity funding;
- Pathway's bankers' commitment to provide additional finance will be limited in amount and subject to conditions - it will not be possible to ensure satisfaction of these conditions in advance;
- the presence of a comprehensive security package will severely restrict Pathway's access to finance from other sources.

Claims Risk on the Service Provider

In the event that the contract with Pathway is terminated by virtue of a Pathway default and the contracting authorities seek damages, they will be in the position of an unsecured creditor behind the bank's secured position. Significant risk must therefore be associated with the likelihood of receiving any such damages.

Termination Risk

Pathway strongly favour the contracting authorities assuming obligations to acquire parts of the automation service that have been rolled-out and are operating successfully. These termination amounts may not reflect the market value of these assets nor the utility value of the assets to a new operator.

These risks have to be viewed in the context of the issues described below.

Choice

The contracting authorities will need to satisfy themselves that potential service providers' financial structures do not pose significant risks.

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Benefit Payments Sensitivity

Should the chosen service provider have financial problems that affect the operation of the benefit payments system there could be serious consequences for benefit claimants with obvious repercussions.

POCL's Commercial Strategy

POCL's future financial performance will be dependent upon the satisfactory delivery of the automation service. As such the long-term financial viability of the service provider is vital.

PFI

The contracting authorities are not satisfied that Pathway's proposal on termination risk complies with the principles of transfer of risk embodied in PFI.

Conclusion

At the meeting held yesterday the Programme recommended that the class A risk associated with Pathway's financial structure could best be addressed by the provision of joint and several guarantees from each of Pathway's shareholders for all Pathway's obligations under the automation contract.

Finally, it was agreed at the meeting that you would respond to the contents of this letter by Friday, 8 December 1995. Please submit your response by 5:30 p.m.

Yours sincerely,

GRO

PAT KELSEY
Head of BA/POCL Procurement Group

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①...»: 12:39 pm, Tuesday, 5th December, 1995

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From:
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TO:TONY OPPENHEIM

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