

Projects Brief

Summer 2010



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Welcome

At the time the Projects Brief is going to press, there is a gathering cloud over the future of PFI and its hybrid forms of procurement (such as BSF) in certain sectors. With the new Government forced to bring down the public sector debt, any form of procurement that involves funding from the public purse will undoubtedly come under the spotlight.

However, what is absolutely clear, is that for the UK to make a long term, sustainable recovery then investment in public infrastructure is a must. It does not take an economist to identify the causal link between recession, higher unemployment, spiralling housing waiting lists and a need to increase affordable housing.

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A Reason for Optimism Amongst the Gloom?

Further, with the Coalition's commitment not to reduce NHS funding and a similar commitment to continue investing in education (albeit perhaps in a different manner than through BSF), the future for the PPP industry is perhaps not as bleak as many suggest.

However, the industry will almost certainly have to change. Greater efficiency in terms of procurement and delivery and reduced expectations in terms of financial returns are essential. Likewise, a loosening of the rigid processes and fetters that currently go hand in hand with PFI. We are already seeing more innovative and less rigid models of public private partnerships and this has been given a further stimulus by the recent Treasury Guidance on Joint Ventures.

So whilst a slow down of PPP activity over the next few months is inevitable as the extent of the UK's borrowings become clearer, traditional methods of PPPs are more vigorously tested for value for money and new ideas emerge, we

believe that there are grounds for optimism. However, it is incumbent upon all of us to see how we can work together to translate this optimism into delivered Projects.

Paul Buckland, Partner, Projects Group

If you would like to discuss the future of PPPs and future delivery models, why not get in touch:

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2 Projects Helpline

Devonshires Projects Department will shortly be launching a free Projects Helpline. This is intended to provide an accessible, first port of call for those who would like an initial view on a legal issue that has arisen on a PPP project that has been awarded. The help line will provide access to specialists in employment, commercial, PFI, LIFT, procurement, corporate, banking, construction, FM and disputes, all within a PPP context.

To find out more contact:

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New Faces

Chris Judge has recently joined us as a trainee solicitor. The Projects Group is Chris' second seat with Devonshires, having begun his training contract in our Housing Management department. We also welcome back trainee solicitor Hannah Jefferson who is staying with us for a second stint in the Projects Group.



What Next for PFI?

In an article concerning the role of PFI under the new government, Rebecca Pearey explains why she considers PFI definitely has a future.

The Private Finance Initiative ('PFI') was first introduced in the early 1990s by Conservative Chancellor, Norman Lamont. However, it was not until Labour came into power in 1997 that PFI started to be used more widely as a mechanism for delivering projects through local authorities. The Labour Government has since signed more than 640 PFI contracts, despite PFI coming under ongoing scrutiny over procurement costs, balance sheet treatment and risk transfer.

All of these are issues that could potentially resonate with the public in the current economic and political climate. Not surprisingly, with the recognition that the public sector balance sheet is unable to take much more stress, there have been murmurings from within the Conservative party suggesting that the days of PFI may be numbered. Perhaps the strongest statement to date has come

So, on this evidence, does the election of a Conservative led coalition government spell the end of PFI? Whilst there is perhaps nothing more risky than making policy predictions, our instinct is to say "no", we think not.

Our view is that the ire of the Conservatives is directed less at PFI itself, and more at "Labour PFI" (note the quote from George Osborne above) and certain of its perceived characteristics. For example, last year, the Conservatives published a policy briefing, *Reconstruction: Plan for a strong economy*, which set out 5 key principles to be complied with for all PFI contracts under a Conservative government. The 5 key principles are as follows:

1. Proper Accounting. All public sector contractual payments to private promoters will be taken into account when assessing the sustainability of the public finances.
2. Proper incentives for the private sector. All state contracts with private promoters will include a few simple and clear outcomes, and the private

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from George Osborne, the then shadow chancellor. He commented in November 2009 that "Labour's PFI model is flawed and must be replaced. We need a new system that doesn't pretend that risks have been transferred to the private sector when they can't be, and which genuinely transfers risks when they can be."

We also understand that the Conservatives instructed Philip Hammond, then the shadow chief secretary to the Treasury (and now Secretary of State for Transport), to investigate alternative funding models for major projects that deliver better value for taxpayers. There have been calls from within the party for more transparent accounting in order to remove the "perverse incentives that result in PFI simply being used to keep liabilities off the balance sheet". (A viewpoint incidentally that the shadow chief secretary to the Treasury, Liam Byrne, perhaps does not share, instead commenting that ending PFI could transfer more risk to the public sector).

promoters will pay liquidated damages if those outcomes are not delivered.

3. Where a Government subsidy is justified in order to make a project economically viable, it should be made transparent. If the wider social and economic benefits of the project justify the subsidy, then the subsidy should be made explicit by financing it through government spending.
4. Private sector must bear the risk. The Conservatives will engage private providers if they can effectively transfer all those risks which are reasonably within the control of the providers. If no private provider is willing to bear the vast bulk of the risk, then the project should either be abandoned or take place in the public sector.
5. No micromanagement. All contracts will be negotiated so as to allow the government to terminate the contract and seek liquidated damages in the event that the private promoter fails to deliver.

Our belief is that the Conservatives will be focusing on addressing these issues, rather than engaging in a wholesale abandonment of PFI. Lest we not forget, PFI has been, in pure delivery terms, a very successful and well established method of procuring public sector assets through the use of private sector capital. So successful in fact that it is being replicated throughout Europe, the Americas, Australia and Asia. Whilst few would deny that it could benefit from a review and some fine-tuning, would any new government really dispense with such a tried and tested mechanism of leveraging private sector finance into the economy? Particularly at a time when not only is public sector capital in such short supply but also there is no viable alternative to replace it.

Indeed, recent Conservative statements on the future of PFI have perhaps become a little less bullish. Their criticism of PFI has become narrower and has tended to focus on specific public service areas. It is Education (Building Schools for the Future), Health and Waste that have been the sectors that have borne the brunt of the Conservatives' most recent call

forever changing. Whereas not so long ago, large, institutional multi disciplinary acute hospitals were seen as the blueprint for healthcare, we now have far more sophisticated local (and in some cases mobile) facilities from which specialist services and procedures that were formally the preserve of those large acute hospitals, are being delivered.

Waste management is another area that has been transformed and will continue to adapt. The drivers here are perhaps different. Climate change, the need to make better use of our limited resources and a better understanding of the implications of landfill, incineration and recycling have all led to an ever changing regulatory environment which is set to continue to evolve as we strive for the optimum way in which to process and dispose of our waste. With technology also advancing quickly to respond to all of these challenges and opportunities, a conventional PFI contract has to incorporate very considerable (and non punitive) flexibilities to be able to serve the sector well over a 30 year period. Education partnerships require similar levels of flexibility.

“Housing involves the use of assets and the provision of services that are clearly suited to long term contractual arrangements such as PFI”

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for change, whilst housing has stayed out of the firing line despite the £1.8bn investment set aside for the forthcoming round 6 Housing PFI Projects.

We believe the reason for this is that Housing involves the use of assets and the provision of services that are clearly suited to long term contractual arrangements such as PFI: with the greatest respect to our construction and housing colleagues, there is only so much change that can be brought to a dwelling and the services that that dwelling requires.

Also, the “private sector” has been delivering affordable housing for 30 years or so and well established methods of service delivery by a large pool of regulated and effective providers already exists.

This contrasts with sectors such as education, waste management and health. These are areas where substantial change is inevitable over a thirty year period, whether driven by the dynamic and complex nature of the service relationships and aspirations or simply by technology. For example, the approach to delivering health services is

So, based upon this analysis, PFI within a housing context looks very different and, in our opinion, a far better, long term fit for the current PFI model than is the case with certain other sectors. That said, we still do not believe that PFI will disappear from these other sectors. It will undoubtedly change and may even be re-badged under the new government but, at the moment there is no evidence of any readily available alternatives. PFI has been delivering projects across a wide range of public services for over 10 years and, during that time it has remained under a very bright and critical spotlight. It may be over simplistic for a new government to wave a magic wand and produce a viable alternative.

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The Community Infrastructure Levy 2010 and Exemptions

The Community Infrastructure Levy ("CIL") Regulations have now been issued and came into force on 6th April 2010.

CIL is a levy payable to Collecting Authority's ("CA" which will include unitary authorities, district councils, London borough councils) on the implementation of a planning permission. The CIL is intended to provide greater transparency and certainty for developers than the current system of individually negotiated section 106 Agreements. There are certain types of development which will not fall within CIL for example, roads and railways.

A CA who collects CIL will utilise the same to provide infrastructure in their area. The amount of payment required will be decided once a CA has put a charging schedule in place. There are numerous hoops which a CA will need to jump through before a charging schedule will be set in stone. This will include consultations with planning authorities, members of the public and businesses within the area and any other interested parties.

Under the current proposals, the Government intends to reduce the use of Section 106

In order for the charities relief to be claimed, the charity must own the interest in land solely or with another charity.

3. Social Housing Relief –

The Regulations set out a reduced rate of CIL for all affordable housing developments. There are conditions set out within the Regulations being that the development comprises or is to comprise qualifying dwellings. A qualifying dwelling is a dwelling let by a private registered provider of social housing, a resident social landlord or a local housing authority on a particular term (i.e. assured tenancy, secure tenancy, shared ownership lease etc).

The Regulations set out details as to how the amount of social housing relief will be calculated.

The procedure for claiming relief will depend on who the developer is and what relief if any is being claimed. A relief must be claimed prior to commencement of development and a CA must notify a developer within fourteen days of receiving a form claiming the relief.

If relief is granted then the developer must inform the CA in writing if the development ceases

"The CIL is intended to provide greater transparency and certainty for developers than the current system of individually negotiated section 106 Agreements"

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Agreements to fund infrastructure and it is the intention that a CA will charge CIL rather than use a Section 106 Agreement. The regulations state that a Section 106 Agreement should only be used in order to deal with affordable housing (and Crossrail).

At present there is no requirement for a CA to adopt the CIL.

The CIL Regulations provide that there are exemptions to and reductions from CIL which are as follows –

1. Mandatory Exemption for Charities –

A charity will be exempt from paying CIL where it uses a development wholly or mainly for its charitable purposes and it will be "liable in default" to pay were it not exempt. This exemption will only apply where only the charity and no other third party uses the part of the development for a charitable purpose.

2. Discretionary Relief for Charities –

A CA has a discretion to apply exemptions to or reductions from CIL where a development is to be held by a charity as an investment from which the profits are applied to its charitable purposes.

to be exempt within seven years following commencement of development.

It is unlikely that any CA will have a CIL charging schedule in place by the end of 2010 however if the Government's proposal that Section 106 Agreements will be phased out is successful then a CA will have no alternative but to put in place a charging schedule.

It should be noted that in February 2010 the Conservative party outlined plans to scrap CIL and non-site specific planning obligations and to introduce a single unified local tariff to all residential and non-residential development at graded rates depending on the size of the development.

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The New Remedies Directive - Notification Requirements, Award Decision Notices & the Standstill Period

Introduction

The Remedies Directive introduces some important changes to the notification, award decision notice, and standstill period requirements under the Public Contracts Regulations 2006 (the “Procurement Regulations”). This article explores the key changes in this important area of the legislation.

The New Notification Requirements

The Remedies Directive introduces a new Regulation 29A into the Procurement Regulations. Under this Regulation, contracting authorities have an explicit obligation to notify an “applicant” that is excluded prior to the award decision stage of its exclusion from the procurement process. An “applicant” for this purpose is any bidder who submitted a Pre Qualification Questionnaire (PQQ) or a tender.

The effect of this new Regulation is that the contracting authority will have to notify a bidder if it is eliminated at the PQQ stage, or at any stage of

the contract to it must send the Award Decision Notice (“ADN”) to the bidders that submitted a tender (referred to as the “tenderers”) and the bidders that were unsuccessful at the PQQ stage (referred to as the “candidates”). The ADN must be sent “by the most rapid means of communication practicable”.

The ADN to the tenderers must include:

- The name of the successful tenderer;
- The contract award criteria;
- The score obtained by the successful tenderer;
- The score obtained by the recipient of the ADN;
- The reasons for the decision, including the characteristics and relative advantages of the successful tender; and
- Details of when the standstill period is expected to end and how the timing of its ending may be affected by any contingencies.

“The Procurement Regulations do not prescribe what form the notification should be in, but written notification is obviously preferable.”

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a competitive dialogue procedure prior to the final tender stage. In practice, contracting authorities probably do this anyway, but the new provisions make it an express obligation, and a failure to comply will be a breach of the Procurement Regulations.

The Procurement Regulations do not prescribe what form the notification should be in, but written notification is obviously preferable. If following receipt of this notification a bidder submits a written request for the reasons why it was unsuccessful, the contracting authority must provide the bidder with such reasons within 15 days of the date of the request.

The Award Decision Notice

Regulation 32 of the Procurement Regulations (which deals with the procedure on contract award) has been substantially amended by the Remedies Directive. Once the contracting authority has decided which bidder to award

The ADN to the candidates must include:

- The reasons why the candidate was unsuccessful;
- The name of the successful tenderer;
- The contract award criteria;
- The score obtained by the successful tenderer;
- The reasons for the decision, including the characteristics of the successful tender; and
- Details of when the standstill period is expected to end and how the timing of its ending may be affected by any contingencies.

The key thing to note about the requirements of the ADN is that the reasons for the decision, including the characteristics and relative advantages of the successful tender must be fully set out in the ADN. Prior to the implementation of

the Remedies Directive, contracting authorities only had to provide this information to bidders that asked for it.

This could be quite an onerous requirement for contracting authorities to comply with, particularly where the contract being procured is a large scale Framework Agreement with numerous successful and unsuccessful bidders.

A failure to include the appropriate information in the ADN will render it defective for the purposes of the Procurement Regulations. This in turn could lead to an allegation from an unsuccessful bidder that the contracting authority has failed to implement a proper standstill period, as the standstill period cannot begin to run until proper ADNs have been issued to the bidders. If the contracting authority were to enter into the contract with the successful bidder in circumstances where it has not implemented a proper standstill period, an unsuccessful bidder may have grounds for bringing an “ineffectiveness” claim to get the contract set aside / cancelled.

after the sending date.

Where the ADN is sent to all bidders by other means only, the standstill period ends on the first to occur of:

- midnight at the end of the 15th day after the sending date;
- midnight at the end of the 10th day after the date on which the last bidder received the ADN.

Where the last day of the standstill period is not a working day the standstill period must be extended to midnight at the end of the next working day.

Summary

There is little doubt that the changes introduced by the Remedies Directive can be viewed as “bidder friendly” changes in that they provide for greater transparency when it comes to providing unsuccessful bidders with details of why they have been unsuccessful, thus giving bidders

“the changes introduced by the Remedies Directive can be viewed as “bidder friendly” changes”

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Regulation 32 makes it clear that there is no need to issue an ADN where:

- the contract can be awarded without prior publication of an OJEU Notice (eg a below threshold contract or one for Part B services);
- there is only one tenderer and no candidates; or
- the contract is being awarded under a Framework Agreement or Dynamic Purchasing System.

The Standstill Period

Under Regulation 32A of the Procurement Regulations the contracting authority must not enter into the contract with the successful bidder before the end of the standstill period.

Where the Award Decision Notice is sent electronically or by fax to all bidders the standstill period ends at midnight at the end of the 10th day

greater opportunity for challenging the decision. The standstill period between notification of the award decision and entry into the contract has always been important, but the new rules make its significance even greater, not least because a failure to comply with the standstill requirements could put the contract at risk of being declared to be “ineffective” by the court.

For further information on the issues raised in this article please contact:

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Equivalent Project Relief – Some Respite for PFI Sub Contractors?

Introduction

In a typical PFI project, a project company formed by the private sector (“ProjectCo”) enters into a Project Agreement with the public sector (the “Authority”). Although it will arrange for the funding of the project, ProjectCo will generally be little more than a thinly capitalised shell company. It is therefore critical that ProjectCo enters into sub-contracts under which its obligations under the Project Agreement are carefully flowed down to its sub-contractors.

Pay-When-Paid and the Housing Grants, Construction and Regeneration Act 1996 (1996 Act)

Market practice prior to 1996 was such that the use of construction sub-contracts containing “pay-when-paid” clauses was prevalent throughout the construction industry. These restricted the right of a sub-contractor to payment from its employer, until its employer had itself received payment. Not surprisingly these provisions were hugely unpopular with sub-contractors and their prohibition by Section 113 of the 1996 Act was widely welcomed by many.

the Treasury acknowledged the adoption of the EPR approach within the contract structures to be adopted for a PFI Project. Therefore, there would appear to be tension between legislative interpretation and central government policies.

Local Democracy, Economic Development and Construction Act 2009 (2009 Act)

The 2009 Act received Royal Assent on 12 November 2009 and it is expected to come into force in late 2010 or early 2011. When it does so, Part 8 of this Act will amend the 1996 Act to prohibit “pay-when-certified” clauses.

Does this mean that the demise of EPR is finally in sight? Not necessarily. The 2009 Act also inserts a new section (106A) into the 1996 Act which confers on each of the Secretary of State, the Scottish Ministers and the Welsh Ministers, the power to disapply any of the construction contract provisions in Part 8 of the 2009 Act in relation to certain categories of construction contracts. Due to the genuine need for EPR within a conventionally project finance PFI

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Effect of the 1996 Act on PFI Projects: Pay-When-Certified and other solutions

In light of the prohibition of “pay-when-paid” clauses, the PFI industry devised drafting to bypass the provisions of the 1996 Act, to try and ensure that sub-contractors only receive entitlements under their sub-contracts to the extent that ProjectCo has actually received a similar entitlement under the Project Agreement. This approach has become known as ‘Equivalent Project Relief’ (“EPR”) or “Derived Benefits” and now appears in virtually all PFI contract structures. The approach focuses less on when the employer (e.g. ProjectCo) actually receives payment from its client, and more upon when the employer actually becomes entitled to be paid by its client (e.g. a “pay-when-certified” approach).

Uncertainty surrounding the enforceability of EPR

However, the decision in a 2005 case (Midland Expressway v Carillion) reinforced doubt over the enforceability of EPR, even though certain industry Standard Form Contracts approved by

structure, it is suggested this power should be used to exclude PFI sub-contracts from the prohibition.

Conclusion

Under the 2009 Act both “pay-when-paid” and “pay-when-certified” (or equivalent) provisions will, in the absence of any intervention by the Secretary of State, be unenforceable in England. However (and perhaps significantly) the new Act does not prohibit the use of deferred payment periods. Therefore, whilst PFI sub-contractors may be rubbing their hands in glee at the potential demise of EPR and the prospect of an accelerated right of payment, they could find themselves back to square one with the simple use of unduly long payment periods.

If you would like any assistance in this regard, or further information in relation to EPR, please contact:

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