

BACK TO THE FUTURE? PROSPECTIVE ISSUES IN PFI/PPP¹

By Sean Wilken QC



It may seem hard to believe for some but on 12 November 2019, PFI turned 27 years old.² Quite apart from amounting to depressing evidence for those of us who have been in practice almost throughout that time as to the time that has passed, this anniversary is important for another reason. It means that the time is approaching for many of the assets created under the first generation of PFI projects to be handed back, as Sean Wilken QC discusses in this article.

For most of us involved in disputes, our caseload over the years has involved the issues arising in procuring the project, obstacles to the asset being created (in the case of the Birmingham North Relief Road or the M6 Toll Road as it is now known, dealing with planning and protestors) and then defects in either the construction or operation of the asset. The idea that there might be a valuable asset to be handed at the end of the Concession Period has rarely crossed our minds. This is the case even though the whole point of the PFI/PPP system was to generate a valuable asset for future use at the private sector's risk.

As handback approaches, however, there will undoubtedly be disputes. The purpose

of this article is to discuss what type of disputes they might be and how we as litigators can best assist in the effective resolution of those disputes.

Obviously the provisions for handback will depend on whether this is a Project or Concession Agreement,³ the asset, the scale and length of the Concession and the respective bargaining positions of the parties at the original tender. One result of that is that handback and the issues associated with it can take a myriad of forms. That means, of course, it is difficult to draw out general principles and much will turn on the terms of the particular Concession.

This article does not therefore address any specific case or agreement wording. Nor does it offer an answer to a particular problem. The article instead addresses the range of issues that may arise breaking them down, for present purposes, into the following: what will be handed back; to whom and with what short/long term issues.

What will be handed back

Where the asset is a discrete building without tenants or leaseholders and where the Concessionaire holds the freehold free and clear, then, perhaps, it could be said that it is easy to identify what is being handed back.

Yet, even here, issues may arise:

1. What will happen about the fixtures and fittings?
2. How will provision be made for the transfer of staff under TUPE/the ARD? What is the undertaking being transferred?
3. What happens to the know-how acquired over the life of the Concession?
4. What provision has been made for any goodwill associated with the asset?
5. What will happen to the data associated with the Concession?

Often, of course, the asset will not be a discrete building, the asset can include:

1. Multiple structures on different sites which may have different forms of land tenure;
2. Structures where, for example, the Concessionaire holds the freehold but there are numerous long term leases which will outlast the life of the Concession;
3. Structures where the Concession owns the freehold but the asset is actually a leasehold asset;
4. Assets on fragmented sites or sites with complex and fragmented title.

In each case, thought will have to be given to unbundling and then rebundling the asset – in fact and law – valuing that asset if there is an end of Concession payment to be made; and then seeing what, if any, market value the asset has.

None of the above are necessarily straightforward and it is easy to see how, without adequate preparation, there could be pitfalls.

To whom will the asset be handed back?

As to what will in fact happen much depends on the political complexion of the country at the time of handback and, of course, the state of the government's finances.

That said, there are three options:

1. A return to State ownership;
2. A further concession period;
3. Variants of outright sale, some form of sale and leaseback and so on.

“There are pragmatic difficulties in simply returning the asset to State ownership.”

All things being politically equal, a return to State ownership will may well entail a capital cost on the part of Government and the only way to avoid that would be some form of renationalisation legislation. Here, depending on the compensation paid (or not paid) there may obviously be issues over valuation and, ultimately, if there is a State deprivation of property disputes under Article 1, Protocol 1 of the European Convention on Human Rights as incorporated by the Human Rights Act 1998.

Such complications aside, there are pragmatic difficulties in simply returning the asset to State ownership. In circumstances where the state has divested itself of the staff – both in terms of the staff associated with the asset but also in terms of monitoring, oversight, know-how and long term planning – how the returning asset will be cost effectively managed must be open to question.

The second will in theory attract the various forms of procurement regulations.⁴ Further, if there is any doubt over the asset being transferred, the state in which it is being transferred and the life cycle, that will complicate the tender process – both in terms of scope and price. Further still, provision would again have to be made for know-how, data and so on.

The third is a straightforward asset sale. It has the virtue of simplicity but could leave many questions unanswered – as to the nature of the rights retained and leased back; the costs and the long term future of the project.

Short and long tail liabilities

State and value of the asset(s)

With a short term single asset, the issue will be one of survey. Where there are multiple assets, this problem will be more logistically complicated.

Perhaps two of the thorniest problems will be surveys of a complicated estate of assets where there are differing assets in differing conditions.



⁴ On the assumption that the regulations or an equivalent still exist.

¹ This article has its origin in a roundtable kindly hosted by DLA Piper, Affinitext and the Partnership Bulletin. The views and errors are my own and no one else's.

² PFI was announced in the then Chancellor of the Exchequer's Autumn Statement – see – <https://publications.parliament.uk/pa/cm201012/cmselect/cmtreasy/1146/1146.pdf>

³ I use the term Concession for the rest of this article as this represents the more extreme case.



“Handback will pose many challenges irrespective of the type of PFI/PPP arrangement and whether that project has been successful or not. Those challenges will be logistical, financial and legal – if not an interplay of all three”

Not only will there be the logistical issue of simply having the time and capability to carry out surveys (which will require forward planning) but there will also be two potential points of principle.

First, does the estate have a value greater than the sum of its parts? If so, how is that to be calculated? What is to happen if the estate has been viewed as a whole whilst within the PFI/PPP Scheme but government has different plans for it? The value to the State may be less if the government is to fragment it or to use it differently. The value invested by the PFI/PPP remains, however, the same.

The second problem is the operation of the compensation provisions (if any) or retention fund (if any).

As far as the compensation provisions are concerned, here one can see issues of principle – do the provisions allow for unbundling? What allowance does the formulation allow for intangibles associated with the assets (good will etc)? What provisions are made for the whole being greater than the sum of its parts? What account is taken of the possible difference between the value to the State and the accrued cost/value to the PFI/PPP entity?

As far as the retention fund is concerned, the size and allocation of the fund will depend on the surveys and whatever view is taken of the lifecycle of the asset or estate. Again there will be scope for differing views.

The final and most difficult problem will be how does one value those projects that have been historically “problematic” or poorly performing?

Here there are two scenarios – where the project has turned the corner and the problems have been resolved and where the project has not.

In the first, there is obviously the question of has the project in fact turned the corner. The more complicated issue is how does one value a historically difficult or damaged project? There will be a series of imponderables here – was the project problematic due to financial issues – cashflow; loss of profit; the need for additional equity? Or was it due to defects in the structures – latent or otherwise? Or were there problems with the service provided? In each case, there will be differential impacts on the value of the project.

In the second, an obvious issue is whether the fact that a less than perfect asset or estate is being returned to the State at the end of the life of the project was ever envisaged by the parties. After all the whole intent of concessions was that the State would receive something valuable at the end of life. Thus the parties may never have addressed the question of how an asset which has some but not the envisaged value will arise.

Lifecycle/Longevity

There will be two main issues here.

First, what to do with an asset whose planned lifecycle is close to that of the Concession Agreement itself. Where the planned and actual lifecycle are the same, then there should be no issue. The Concession was for the life of the agreement and is being handed back on

that basis. Where, however, the actual lifecycle is longer than the planned lifecycle (due to, for example, advances in technology or effective maintenance and upgrading during the concession), the parties may well not have intended that the Concessionaire would receive compensation. If that is clearly expressed in the wording, then the Concessionaire will simply have to absorb that fact. If it is not clearly expressed, however, there will be debates over how the compensation provisions are to be operated.

Second, inherent within PFI financial models are assumptions as to the spend over the life of the project – including what, if anything, will be spent on the repair, upgrading or replacement of assets under the Concession Agreement. In terms of the actual repair, upgrading and replacement, there will obviously be room for the exercise of commercial judgment – both in terms of that which is in fact necessary and, as the Concession draws to a close, that which the Concessionaire is willing to spend thereby reducing profit on an asset which is in any event transferring back.

These are all issues on which there is room for disagreement between the State and the Concessionaire. A Concessionaire may have acted perfectly legitimately but the State has unrealistic expectations as to what will be handed back. Alternatively, the State may legitimately suspect that there has been insufficient spend in the final years of the project. There is then the third possibility of a legitimate spend but with latent defects or problems which impact on the future lifecycle of the asset.

Disputes and dispute resolution

As can be seen, handback could give rise to questions of principle, of process and of quantification. With sufficient advance planning, it is to be hoped that the parties will allow sufficient time to work out their differences well in advance so that there can be a smooth and non-contentious handover.

“It is worth remembering that the Dispute Resolution Procedures in the Concession Agreement can often be the start rather than the end of the means to resolve a debate.”

That does, however, require sufficient advance planning. That planning must also take account of the possibilities that the parties may, perfectly legitimately, not agree. In that process, the parties may need both to realise that they harmoniously can agree to disagree and use the Dispute Resolution Procedures in the Agreement to resolve the points of difference in the most cost effective and efficient fashion possible.

In that process, it is worth remembering that the Dispute Resolution Procedures in the Concession Agreement can often be the start rather than the end of the means to resolve a debate. The Dispute Resolution Procedures may provide, for example, for an Expert Determination.

This could be a snap, contentious determination or one where the parties had agreed what should be decided and how. On top of that, the parties might decide to put that Determination within an overall mediation or negotiation structure to resolve all the issues between them.

The important points for the parties to realise are that a) there are a number of means of resolving these difficult issues which can be tailored to the Concession Agreement, the project and the issues and which will avoid cost and time; and b) the resolution of disputes need not be antagonistic or contrary to a solid ongoing relationship between the parties. Indeed, the more parties realise that there are genuine differences of opinion between them which can be usefully resolved (as opposed to some zero sum game), the more efficient the process of resolving those disputes will be.

Conclusion

Handback will pose many challenges irrespective of the type of PFI/PPP arrangement and whether that project has been successful or not. Those challenges will be logistical, financial and legal – if not an interplay of all three. Given these challenges and the amounts at stake and even the possibility that some decisions will be very political, it is reasonable to expect at least one party will have unilateral recourse to dispute resolution procedures. That may turn what should be an agreed declaratory process into an unnecessarily contentious process.

The upshot of the above is that those involved in handback need to plan significantly in advance to identify the issues that may arise and the best means of resolving them. This may well require all involved – funders, stakeholders and advisors – on both sides – working together to identify the critical issues and the best means of resolving them. In that process, it must be borne in mind that an efficient and cooperative use of lawyers and the various means of resolving a dispute may prove, in the long term and to the surprise of some, to be both cost effective and non-contentious.