

INSIDE THIS ISSUE

MAKING SAVINGS IN OPERATIONAL PFI CONTRACTS

SCOTTISH MARKET UPDATE

THE TWO-TIER WORKFORCE

COMMUNITY BENEFITS IN PROCUREMENT

macROBERTS

Spring
2011

PROJECTS NEWS

MAKING SAVINGS IN OPERATIONAL PFI CONTRACTS - TREASURY DRAFT GUIDANCE

In line with belt-tightening across the board, the Treasury has issued a draft guidance note on "Making Savings in Operational PFI Contracts". It aims to assist PFI Contract managers to identify and implement measures that will "reduce costs while maintaining frontline services".

As a pilot project, the contract for the Queens Hospital in Romford will be examined by a team of legal, technical and other professional advisors to look at where costs can be cut and money can be saved. It is anticipated that the draft guidance will be updated to reflect the success, or otherwise, of this pilot scheme, the results of which are anticipated this spring.

So what is required to make these cost savings? Well, according to the draft guidance it could be any number of things, and not all of these involve changes to the PFI contract itself.

Firstly, it is important to ensure that the contract, in its current form, is working as efficiently as possible by, for example:

- Managing the existing contract properly;
- Increasing occupational density;
- Looking at the insurance cost sharing provisions;
- Optimising management and use of assets;
- Considering any spare capacity which could be "mothballed";



- Reducing energy consumption;
- Reviewing service scope and standards. However care must be taken to ensure that the provision of core services is not harmed;
- Removing or re-scoping "soft" or ancillary services;
- Introducing value testing;
- Taking back the project company's share of "general change in law capital cost risk"; or
- Aligning value testing exercises.

If these measures are insufficient, changes to the contract may be necessary to save money. However, the guidance notes it is important to ensure that savings are not outweighed by the cost of implementing the changes; whether legal costs, those of technical advisors, or otherwise!

Suitable cost transparency measures may also require to be agreed. Although SoPC4 contracts

have a high level of cost transparency, older contracts often do not and guidance states it is important that all contracts comply with the SoPC4 transparency standards to allow authorities to make informed decisions on cost saving methods. Likewise, a suitable variation protocol must be agreed if one is not already contained in the contract.

Guidance also cautions that it is vital to ensure that the OJEU or OJEC was drafted in sufficiently wide terms to cover the proposed change to ensure the change does not, in effect, result in a whole new contract. If there is deemed to be a "new contract", the contract would have to be re-tendered.

PFI contracts have a long life span and it is vital that any changes made to the contract are able to endure. As such, any proposed changes, either in how the existing contract is managed, or to the contract itself, will require careful consideration and it is important to seek legal advice at an early stage.

SCOTTISH MARKET UPDATE

Scotland's Spending Plans and Draft Budget 2011 - 2012

In November 2010, the Scottish Government announced budget cuts of £1.3bn, emphasising the scale of the financial challenges which Scotland must now face. One of the most important features of the budget was the announcement by the Scottish Government of the new pipeline of revenue financed investment, which is estimated to be worth up to £2.5 billion.

The Scottish Government has requested that the Scottish Futures Trust (SFT) takes forward and delivers this £2.5 billion worth of projects in partnership with public sector partners such as the Scottish Government, local government, NHS boards and other local bodies, through the use of the NPD (Non-Profit Distributing) model.

What is the 'NPD' Model?

An "NPD" project is a distinct type of PPP project. An NPD organisation is a private sector entity, which is operated on a commercial basis. The organisation's profits cannot be distributed in the usual way and must be re-invested by the organisation to further its objectives. Although the NPD organisation's ability to

distribute profits is restricted, there is no restriction on sub-contractors' ability to make profits under sub-contracts.

Whilst capturing the traditional benefits of PFI/PPP with regard to risk transfer etc, the NPD model is also intended to ensure:

- better value for money;
- promotion of community involvement;
- no profits are made beyond payments made to sub-contractors;
- there is a fixed or capped return to investors; and
- any surpluses are made available to a Charity or to the contracting Authority itself.

The NPD model has developed mostly through procurement in the health and education sectors. NPD is, however, being used in other sectors and is currently being used on the Borders Railway DBFM

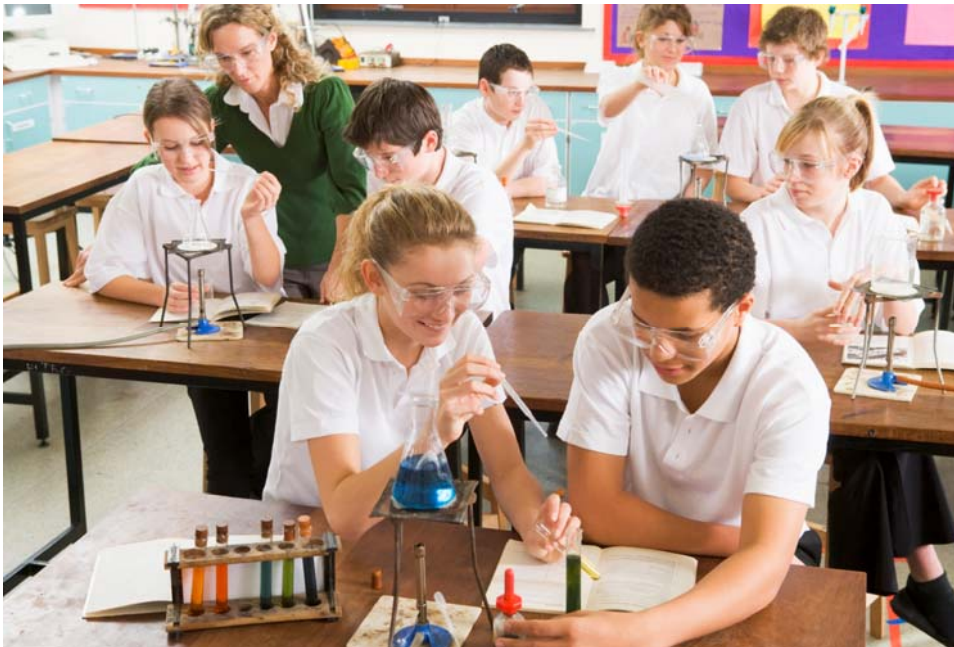
Project. The potential benefits that this distinct type of PPP project could bring are now being widely recognised.

The Scottish Futures Trust: Business Plan 2011 - 2012

The Scottish Futures Trust's (SFT) Business Plan was published on 15th March 2011. The Plan sets out the key objectives of the SFT in the year to March 2012. SFT's budget for the period is £5.55 million and two thirds of that budget will be allocated to hub, schools, waste, housing and financing. Anticipated projects include:

Education: Capital Value of up to £750 million

Specific projects within the Schools for the Future programme are likely to be procured through the NPD model, via hub.



- **Schools:** There are 35 schools included within Phase 1 of the £1.25 billion Scotland's Schools for the Future programme. The list of schools which are expected to commence or be on site during April 2011-March 2012 are:

- East Renfrewshire - Eastwood High School (pilot)
- Midlothian - Lasswade High School (pilot)
- West Dunbartonshire - Dumbarton Academy
- East Ayrshire - Gargieston Primary School
- East Lothian - Haddington Infants School; St Mary's Primary School
- Falkirk - New RC Primary School
- Perth & Kinross - Invergowrie Primary School

- South Lanarkshire - Spittal Primary School
- West Lothian - Pumpherston & Uphall Station Primary School.
- **Colleges:** The modernisation of Glasgow College, and improvements to Inverness College and Kilmarnock College, will be funded through the NPD model. SFT will be responsible for introducing the NPD model into the further education sector as it has not been used here before. It is hoped that all three revenue funded projects will be brought into procurement in 2011/12.

Health: Capital Value of £750 million

The Spending Plans of the Scottish Government announced a number of health projects, with a capital value of up to £750 million, which are likely to be procured through the NPD model, including:

- the Royal Sick Children's Hospital and Department of Clinical Neurosciences in Edinburgh
- £300 million of acute health projects, e.g. individual hospital projects.

Transport: Capital value of £1 billion

- Borders Railway project: A new 56km (49km of new line) rail link from the Scottish Borders to the centre of

Edinburgh. It is expected that a contract will be awarded in May 2012.

- M8 Bundle - Baillieston to Newhouse, M74 Raith Junction and M8, M73 and M74 network improvements (Pre OJEU): Procurement expected to commence in 2011.
- The new Aberdeen Western Peripheral Route and the A90 Balmedie upgrade.

Update on the hub initiative

The hub initiative was launched in 2006 and is led by the SFT on behalf of the Scottish Government in order to promote joint working among community planning partners and private sector development partners. The programme divides the country into five 'territories', two of which are now established: the South East hub and the North hub. The five territories are:

- South East hub: during the Plan period, construction is likely to begin on Gullane, Craigmillar, Wester Hailes and Haddington Primary and Infants School.
- North hub: during Plan period, construction is likely to begin on Aberdeen Health Village, Tain and Forres.
- East Central hub: this went into procurement in September 2010; the three shortlisted bidders are Carillion (InspiredSpaces), Amber (FES & Robertson) and Miller/Cyril Sweett.
- West hub: moved into procurement in February 2011, with the bidders day being held in March 2011.
- South West hub: expected to go into procurement in May/June 2011.



Housing

The National Housing Trust (NHT) aims to deliver affordable homes for rent in locations where there is a shortage in the supply of affordable housing. Launched in September 2010, the first phase of NHT is due to complete during spring 2011. A further phase has been announced and is intended to be developed in 2011/12.

Waste

This sector faces a number of challenges. Over the next 10-year period, it has been suggested by the SFT that Scotland will require up to £1 billion of investment in waste treatment infrastructure. In its Business Plan, SFT has announced that it shall support the following three projects:

- Edinburgh & Midlothian Food Waste Treatment Plant which OJEU'd in February 2011, and the Edinburgh & Midlothian Residual Waste Treatment Plant, the OJEU for which is expected shortly;
- Ayrshire Food Waste Treatment Plant whereby a Prior Information Notice was published in February 2011; and

- Glasgow City Council where a PB is expected April 2011.

Tax Incremental Financing (TIF)

The first pilot project in Scotland to use TIF (Edinburgh Waterfront), was approved in September 2010, with a further project (Ravenscraig) getting Government approval in March this year. Secondary legislation was passed in December 2010 to enable six TIF pilot schemes to be developed throughout Scotland. The key principle behind TIF is that the public sector would raise finance for projects by pledging to meet debt repayments from future incremental revenues and other income generated by resultant development.

Defence

There have been some interesting recent developments for Scotland and the UK as a whole in the Defence sector. The MOD recently announced its Next Generation Estate Contracts (NGEC) programme, which is a Defence Estates programme to develop the most cost-effective estate models in order to meet the future needs of defence. The OJEU was published at the end of February 2011 for four Regional Prime contracts (Scotland and Northern Ireland; North of England, Wales, the Midlands and East Anglia; Southwest England; Southeast England).

THE TWO-TIER WORKFORCE

A two-tier workforce is created when employees transfer from the public sector to the private sector and are joined by new employees who have different pay and conditions. This can happen in PFI/PPP and outsourcing contracts.

In 2005, a Code of Practice in Workforce Matters in Public Sector Service Contracts was introduced in England and Wales, to prevent a two-tier workforce arising in public sector procurements. A key provision of the Code was therefore that, where a service provider recruits new staff to work on a public service contract alongside staff transferred from the public sector organisation, it will offer employment on fair and reasonable terms and conditions which are, overall, no less favourable than those of transferred employees.

In December 2010, the Cabinet Office announced that the two-tier Code was withdrawn with immediate effect, the Coalition Government having identified the Code as a barrier to smaller organisations bidding for public service contracts. The Code has been replaced in England and Wales by a Statement on Principles of Good Employment Practice, adherence to which is only voluntary, the Government's



stated intention being that the principles espoused will remain outside of the formal procurement decision-making process.

The Code never applied in Scotland. Here the Scottish Executive agreed with the STUC a protocol and guidance on employment issues in PFI/PPP contracts. Essentially, this provides for no less favourable pay and conditions for new employees in PPP deals. The Scottish protocol and guidance applies only to PPP contracts and not to other forms of private involvement in the delivery of public services. So far, there are no known

proposals for this protocol and guidance to be withdrawn or replaced in Scotland and the impending Scottish Parliament elections will undoubtedly prevent any clarification on approach for some months.

MacRoberts publishes regular e-updates regarding various aspects of corporate and commercial law. If you would like to receive, free of charge, a copy of any of these publications, please register for the topics of interest to you by logging on to www.macroberts.com/e-updates

COMMUNITY BENEFITS IN PROCUREMENT

Over the past few years an increasing number of procuring authorities have aimed to maximise social benefits in their procurements. However, the wish to pursue a particular social aim, for instance the employment of individuals within a specific, perhaps deprived, geographical location, may not always sit wholly aligned with the main purpose of the European Procurement Directives. That purpose is to ensure that there is a level playing field across the European Union for those parties interested in competing for public contracts.

To expand, whilst the Directives expressly permit a contracting authority to use social (and/or environmental) evaluation criteria in relation to public sector contracting, certain conditions must be met. In summary, the criteria must be linked to the core purpose of the contract, must be consistent with the fundamental principles of the EU (e.g. transparency, equal treatment and non-discrimination), and must be identified in the contract notice from the outset.

So, for example, a contracting authority would be prohibited from stipulating in its contract documents that contractors must only use local labour to help reduce high unemployment and increase skill levels in a specific locality. To do so, would clearly discriminate against those contractors who are not locally based. Instead, a contracting authority would be required to incorporate provisions within a contract in such a way as to generate employment and training opportunities for the long-term unemployed without infringing the Directives.

PROJECTS NEWS CONTRIBUTORS:

Lillian Mackenzie (Editor), Sally Murray, Lesley Currie, Kimberley Russell and David Edwards.

Although, it cannot be denied that the inclusion of such so-called community benefit clauses may assist public bodies to deliver social objectives, which in turn may benefit longer-term regeneration and sustainable development, it is this balancing act which has left some contracting authorities, and potentially some interested bidders, feeling slightly uneasy about the legitimacy of social criteria.

This unease has not gone unnoticed by the European Commission, which in January published a new Guide to taking into account social considerations in public procurement.



Through the use of practical examples, the Guide aims to demonstrate the means by which a range of social considerations may potentially be taken into account in order for a public body to conduct, what the Commission has named, 'Socially Responsible Public Procurement' (SRPP). In particular, it is noted that social considerations promoting:

- employment opportunities
- decent working standards
- compliance with social and labour rights
- social inclusion
- equal opportunities
- accessibility design for all (e.g. ethical trade issues), and

- wider voluntary compliance with corporate social responsibility,

may potentially be taken into account depending on the nature of the particular contract.

That said, it is also recognised that community benefit clauses or SRPP shall not be appropriate in regard to every public contract, and indeed a number of practical issues should also be taken into consideration.

Firstly, community benefit clauses may add inappropriately to the cost of the public contract and/or discourage or

eliminate potential providers from a procurement procedure simply because they cannot accommodate a social requirement. Secondly, to be of any merit in practice it shall be necessary for a public body to think carefully about, and then set down clearly, details of "responsibilities, targets with a realistic timescale for achieving them, the management structure for implementing them, the professional and financial resources needed and measures to monitor and report on progress".

A great deal of contract management and compliance monitoring in this way may be off-putting for some public bodies and private sector bidders alike.

The new Guide certainly acts to clarify the range of possibilities open to public bodies, and is a handy tool for understanding how SRPP should be identified and implemented effectively. The Guide also addresses a number of the more practical issues. Nonetheless, care should still be taken for the reasons mentioned here.

To quote from the Guide, "early expert legal advice on establishment of an SRPP action plan is likely to save difficulties later"; a view which we would certainly echo.

Follow our firm on Twitter @MacRoberts

macROBERTS

Glasgow

Capella, 60 York Street, Glasgow G2 8JX
Tel: 0141 303 1100 Fax: 0141 332 8886

Edinburgh

Excel House, 30 Seple Street, Edinburgh EH3 8BL
Tel: 0131 229 5046 Fax: 0131 229 0849

website

www.macroberts.com

A list of members is available for inspection at the addresses above. Regulated by the Law Society of Scotland in the conduct of investment business. © MacRoberts. This newsletter is not intended to be relied upon as a definitive statement of the law and specific advice should always be sought on any particular topic. MacRoberts LLP is a limited liability partnership registered in Scotland (No SO301699)

For further information, please e-mail the editor, Lillian Mackenzie at: lillian.mackenzie@macroberts.com