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Spring 2010

PROJECTS NEWS

THE NEW CRC ENERGY EFFICIENCY SCHEME – WHO IS RESPONSIBLE UNDER PFI/PPPs?

The CRC Energy Efficiency Scheme (the "Scheme") is a new UK energy efficiency scheme which is due to be phased in from April 2010. The Scheme is to be a mandatory cap and trade scheme which will apply to large public and private sector organisations. Failure to register for the Scheme will result in a potentially hefty fine.

Here, we offer a very brief overview of the applicability of what is a very complex scheme, and look briefly at the implications for PFI/PPP projects. More detailed advice should be sought in the event that you are concerned that your organisation might be subject to the Scheme.

When does CRC start?

CRC is due to come into force in April 2010. The introductory phase will run for three years. Subsequent phases will each last for seven years.

For the introductory phase:

- The qualification period is the calendar year 2008. This is the period during which organisations assess whether or not they qualify.
- The registration period is April to September 2010. During this period organisations must submit their disclosure information or register as a participant.
- The footprint year is April 2010 to March 2011. In the footprint year participants will monitor their emissions and determine what emissions are included in the CRC Scheme.
- The first annual reporting year is the same as the footprint year in the introductory phase, but there will be no sale or surrender of allowances. The footprint year is followed by a series of annual reporting years, during which the participant calculates the energy supplies it has included in the Scheme.

The first sale of allowances will take place in the year April 2011-March 2012.

How does the Scheme work?

Put very simply, the Scheme will work by way of allocation, and then trading and surrender, of allowances. Allowances will be sold by the Government at the start of each annual reporting year. Participants do not need to purchase allowances for the first annual reporting year of each phase, but they will have to report their emissions. Following the initial sale period, participant organisations can buy or sell allowances by trading in the secondary market.

Organisations must report their actual emissions by the end of July after each reporting year and surrender allowances to cover their reported emissions. Then, in October in each reporting year, they will, where appropriate, receive a revenue recycling payment, based on their performance in the previous year.

To what entities does the Scheme apply?

The Scheme will apply to organisations rather than to individual sites or properties. Broadly speaking, entities that are part of a group will be taken to be part of the highest parent undertaking when establishing the overall 'organisation'. In the case of the public sector, specific rules will apply to determine when public sector bodies should participate alone or as a group.

Who must register for the Scheme?

Once you have established what constitutes your organisation for the purposes of the Scheme (which may itself be tricky), qualification for participation in the Scheme is based on the total half-hourly metered electricity 'directly supplied' to your organisation during the qualification year. Where your organisation has at least one half hourly electricity meter settled on the half hourly market in the period from January to December 2008, you will need to make an information disclosure under the Scheme. However, where the total half hourly electricity supplied to your organisation during that period is equal to or more than 6,000 Megawatt hours (MWh), your organisation will have to register as a participant under the Scheme.

What does it mean to receive a direct supply?

An organisation is deemed to receive a direct supply when it has an agreement with another organisation for the supply of energy. However, the supplier can be either a licensed or an unlicensed supplier, or any other third party organisation.

There are four key questions to answer:

- Is there an agreement between the two parties that one will supply the other with electricity?
- Is the electricity supplied via a fiscal meter?
- Is the payment for the received supply based on the fiscal meter reading?
- Does the party receiving the electricity via the meter use some or all of the electricity?

If the answer to all four questions is 'yes', the supply will be a direct supply.

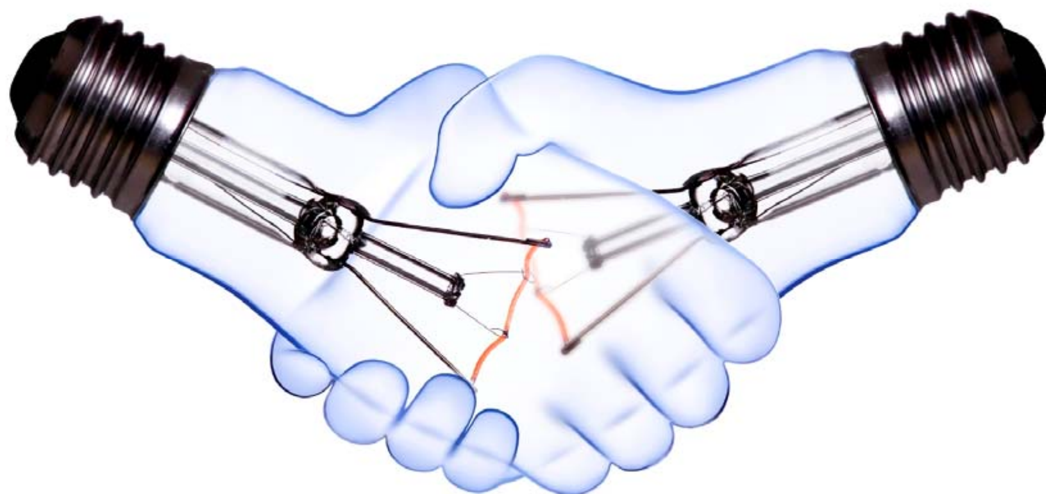
What does this all mean for public sector bodies and companies involved in PFI/PPP?

The question for those involved in PFI/PPP is whether the public authority, the SPV, the sponsors or the FM contractor will be responsible for the supply of energy under the new scheme. Where the public authority is responsible for procurement of utilities, the answer is quite straight-forward: the public authority is responsible under the Scheme. However, on some deals (such as PFI projects on BSF deals), a number of entities will effectively enter into an agreement for the supply of electricity; the Authority will enter into a contract with the SPV, and the SPV may then enter into a contract with the FM contractor, who enters into a contract with the utility provider. So, who receives the direct supply when all parties are entering into an agreement for the supply of electricity and could, to some extent, arguably be using some of that electricity?

"Guidance"

The Environment Agency and DECC have recently issued guidance, part of which makes specific provision for PFI Projects.

In relation to joint ventures and PFI projects, the guidance states that where a "PFI" is responsible for the supply of energy and where a shareholder has more than a 50% stake in a "PFI", it is that shareholder or its ultimate parent which must add the supply to the "PFI" to its energy consumption. Where a PFI company does not have a parent with a greater than 50% controlling stake, the PFI company will itself be required to participate as an individual CRC organisation, provided that the 6000 MWh threshold is exceeded.



One section in the guidance also deals specifically with schools. Local Authorities will be responsible for emissions from all state funded schools maintained by that Local Authority, and school emissions will form part of the Local Authorities' total emissions under the Scheme. However, where a "PFI company" is a counter-party to the supply agreement, the guidance states that the energy use will be attributed to the PFI company, or its ultimate parent.

One would assume that reference to "PFI companies" in the schools example means the SPV or FM company, depending on whether the SPV's obligations are stepped down. However, the guidance also states that where an FM company is providing an electricity supply as a service to its client, the FM company is not using energy for its own purposes and it will not be counted as part of its total consumption. Regrettably, it is not clear how this "use by others" exemption is intended to sit with the suggestion that shareholders in PFI companies (and PFI companies themselves) may be subject to the Scheme.

Conclusion

If you are concerned that you will have to register for the Scheme, you will need to consider the extent of your organisation and check where lies responsibility for procurement of utilities under your contracts. For the private sector it appears that the issue will depend on step-down arrangements and shareholdings, but equity holders, FM companies and SPV's are all potentially liable and should all take a close look at their existing portfolios.

While we wait for the legislation, hopefully some further or revised guidance will be published relating to PFIs. Meantime, Partnerships UK has been commissioned to examine 15 to 20 PFI contracts to determine responsibility in a random sample. Their findings may help to cast some light on the application of the Scheme.

THE NEW PUBLIC PROCUREMENT REMEDIES DIRECTIVE

The Public Contracts (Scotland) Regulations (the Regulations) were amended as of 20 December 2009, with significant new provisions and remedies which apply only to procurements started after that date. Implementing the EC Remedies Directive, the aim of the amendments is to improve the effectiveness of the review of Public Procurements.

Provision of information

Before a public contract may be entered into between a contracting authority and a successful bidder, under the Regulations the authority must have notified all unsuccessful bidders of its award decision. They must also have a mandatory standstill period of at least 10 days from the date on which the authority communicated the award decision to all relevant parties and the date on which it actually concludes the contract.

The revised Regulations increase the range and depth of information which the authority must provide in their notice. The notice must include the criteria for award of the contract, (where practicable) the evaluation scores both of the bidder receiving the notice and the successful bidder, and the name of the successful bidder. The authority must also provide a summary of the reasons why a losing bidder was unsuccessful, the characteristics and relative advantages of the successful tender, and a precise statement of how the standstill requirements affect the notified bidder.

If asked in writing by an unsuccessful bidder, the contracting authority must tell that bidder within 15 days of the request why it was unsuccessful, must disclose the name of the successful tenderer, and, if not already provided, must disclose details of the relative advantages of the winning bid.

However under the revised Regulations, if a contractor asks for that information before midnight on the second working day after despatch of the notice to the unsuccessful bidders, the authority is no longer required to extend the mandatory standstill period to three working days after it has provided details of the relative advantages of the winning bid, as it is still required to do for procurements started before 20 December.

Remedies

Contracting authorities owe a duty to all economic operators to comply with the Procurement Rules. There are existing remedies under the Regulations for contractors in actions against contracting authorities for breach, or suspected breach, of the Procurement Rules. An aggrieved bidder can seek interim suspension of a procedure or implementation of decision or action taken,

and also damages if it suffered loss or damage as a consequence of the breach. The contractor must seek the remedy promptly and in any event within three months of the date when the grounds for the action first arose.

The revised Regulations create further remedies of contract ineffectiveness. The first, second and third grounds for a court to order ineffectiveness of a concluded contract are where:

- a contract is entered into, or a framework is concluded, by a contracting authority without a contract notice having been sent to the Official Journal, when one should have been sent
- a contracting authority has breached the rules on notice to bidders and on mandatory standstill periods, that breach has prevented the bidder from bringing proceedings prior to the contract being entered into, and there has been another qualifying breach of the Regulations duly affecting the chances of that economic operator which is bringing proceedings
- a contract is awarded following a qualifying breach of the Regulations in relation to awards under framework agreements or dynamic purchasing systems.

Proceedings for such orders may be brought before a Court within 30 days of a valid contract award notice being sent to the Official Journal or of all tenderers having been duly informed in writing of a contract award decision, or, otherwise, within 6 months.

Where a contract ineffectiveness order is made, a Court must order the contracting authority to pay a financial penalty, and must also make such orders as are appropriate to address the consequences of the order on the parties to the contract which has been ineffective. The court may order a financial penalty in some other circumstances, notably where it decides (balancing negative consequences and the benefits) not to grant an interim order.

A Court may decline to make an ineffectiveness order if that is in the public interest, but if it does decline, it must order payment of a financial penalty or shorten the duration of the contract.

Commentary

Beyond the obvious strengthening of the remedies for breach of the Regulations in that signed contracts can be set aside with financial penalties, the significance of the revised Regulations lies in the extended scope of information to be given to all bidders, not just to those who take the time to actively pursue details of how the procurement award decision was reached. By requiring such information to be provided, the revised Regulations will lead to far greater transparency than we have seen to date in public procurements.

DAYS ARE NUMBERED FOR EQUIVALENT PROJECT RELIEF (…OR MAYBE NOT)

Pay-When-Paid and the HGCR Act

Prior to 1996 it was common for construction sub-contracts to contain what were known as "pay-when-paid" clauses, restricting the right of a sub-contractor to payment from the main contractor until such time as the main contractor had itself received payment. Not surprisingly, such clauses were hugely unpopular with sub-contractors and were eventually prohibited by Section 113 of the Housing Grants, Construction and Regeneration Act 1996 (HGCR Act).

Effect of the HGCR Act on PFI Projects

PFI Project Agreements were excluded from the scope of the HGCR Act by Exclusion Orders. However, this exclusion did not extend to sub-contracts in PFI projects.

Pay-When-Certified and Other Solutions

Largely driven by funders' demands to ensure that there were no "funding gaps", it was not long before new drafting was devised to ensure that the SPV's liabilities were matched by corresponding entitlements from the public sector authority. These new provisions became known as “pay-when-certified” clauses or "equivalent project relief" (EPR). They generally provided that, rather than the restriction being based on what the SPV is paid by the authority (which is prohibited by the HGCR Act), the restriction became one based on what the SPV is entitled to be paid by the authority.

Latterly, however, doubt was cast on the enforceability of EPR clauses by the decision in England in the case of Midland Expressway v Carillion Construction (No 2) [2005] EWCH 2963 (TCC). Following that decision it became common for those drafting an EPR clause to include a fall-back protection to cover the possibility of the EPR clause not being enforceable. This fall-back protection most commonly took the form of a deferred payment provision which delayed the due date for payment to the sub-contractor, which normally varied from contract to contract from 6 to 24 months. The theory was that this deferment of the entitlement to payment reduced the risk of there being a funding gap, by allowing the SPV time to resolve disputes under the dispute resolution procedures in the Project Agreement and the relevant sub-contract before any obligation to pay the sub-contractor was triggered.

The Impact of the New Legislation

EPR has been dealt a further potential blow by the new Local Democracy, Economic Development and Construction Act 2009 (2009 Act) which received Royal Assent in November 2009. When it comes into force, Part 8 of this Act will amend the HGCR Act to prohibit pay-when-certified clauses such as EPR.

There is, however, a glimpse of light for supporters of EPR thanks to the very late inclusion in the 2009 Act of a new Section 106A of the HGCR 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. It remains to be seen whether this power will be used to exclude sub-contracts in PFI projects from the scope of the pay-when-certified prohibition. It also leaves open the rather confusing possibility that pay-when-certified clauses may be prohibited in PFI sub-contracts in some parts of the UK but not others.

Conclusion

The amendments to the HGCR Act contained in Part 8 of the 2009 Act are not likely to come into force until 2011. No doubt this will allow plenty of time for convoluted alternatives to EPR to be thought up. For example, deferred payment provisions are not expressly prohibited by the 2009 Act. It would therefore be somewhat premature for sub-contractors to treat the passing of the 2009 Act as a cause for rejoicing!

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