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Research and analysis

White Fraiser Report

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Foreword

We have pleasure in submitting our report summarising the results of our review into the status of behaviours, relationships and disputes across the PFI sector, together with our recommendations for how to improve them moving forward.

We have endeavoured to keep this report short and to the point. We are satisfied that there are improvements that all parties involved in the operation of PFI Contracts can make to their behaviours, particularly in the context of their approaches to contract management and associated disputes. It is clear to us that without such improvements being made, there is a real risk that the prevalence of major disputes will only increase and, ultimately, become commonplace across the PFI industry. Avoiding such an outcome is, in our view, in the public interest. A particular concern for us is to ensure that the manner in which PFI Contracts are managed cannot have a negative impact on the wellbeing of those individuals that are either working in PFI facilities or using them. It is against this backdrop that we have made a number of recommendations, which we accordingly submit for consideration by the Infrastructure and Projects Authority.

We could not have undertaken our review without the help and support of all of the public and private sector stakeholders across the PFI industry that so generously gave up time in their busy schedules. We would like to record our appreciation and thanks for their willingness to share their own experiences with us in such an honest, unvarnished and, often, heartfelt manner.

Lastly, whilst this report reflects our engagement with a large number of public and private stakeholders across the PFI industry and will no doubt mirror (and in some cases challenge) the views of many of those and other stakeholders across the PFI industry, this is an independent report and responsibility for any errors or omissions sits with us alone.

Barry White

Andrew Fraiser

Background

In November 2022 the Infrastructure and Projects Authority (the IPA) invited Barry White and Andrew Fraiser to prepare an independent report on:

1. The status of behaviours, relationships and disputes across the PFI sector, together with recommendations for how to improve them moving forward;

2. Recent industry proposals for a “conduct charter” and an “expiry and handback resolution council”; and
3. The extent to which negative working practices are being adopted across the PFI sector, together with the reasons why.

The IPA’s commissioning of this report follows the publication of the Public Accounts Committee’s (the **PAC**) report on “Managing the expiry of PFI contracts” in March, 2021 and the publication of law firm DLA Piper’s “Project Autumn” Report in September, 2022. The PAC’s report, among other things, recommended that the IPA should publish a disputes protocol. DLA Piper’s report was a summary of their “Industry Consultation Report on PPP Handback and Expiry (UK)” which assessed the status of operating PFI projects in the UK and made recommendations for a way forward.

Between them, Barry White and Andrew Fraiser have more than 50 years of experience working in the UK’s PFI sector. Both individually and together (as colleagues and principal/adviser) they were involved in the successful procurement and delivery of many first of their kind PFI projects across the UK. In the early 2000s, Barry and Andrew worked together at Partnerships UK, a public-private-partnership sponsored by HM Treasury that had a unique public sector mission. During that time, Barry and Andrew advised public authorities across the UK on the successful procurement of PFI projects.

Biographies of authors:

Barry White has more than 25 years’ experience in infrastructure development, finance and delivery across all sectors. His roles have included Chief Executive at Transport for the North, Chief Executive at Scottish Futures Trust, Managing Director at BAM PPP UK (now Invesis), Investment Director at Skanska, Project Director at Partnerships UK and Divisional Managing Director at Morrison Construction Group. Prior to that he was an officer in the Army.

Andrew Fraiser is a solicitor in England & Wales with more than 25 years’ experience advising on major infrastructure projects around the world. Between 2000 and 2002, he was seconded to Partnerships UK, where he advised on the government’s standard PFI contract terms and many pathfinder PFI projects. He was a partner at Allen & Overy LLP for 10 years, before joining Ashurst LLP where, until 2021, he was Head of Infrastructure for the Americas and Global Head of Project Finance.

Approach

Given the scope of our brief, we approached our review with three principal objectives:

1. Be as inclusive as possible when gathering feedback from PFI industry participants;
2. Create an environment where consultees would feel comfortable enough to provide “unvarnished” feedback; and
3. Invite feedback from as many PFI industry participants as possible.

From an inclusivity perspective, we are satisfied that we have gathered feedback from a sufficiently broad enough cross section of the PFI industry that was necessary in order for our findings to represent a balanced view of the state of the PFI industry. It should be noted that our findings are not just based on feedback from PFI industry senior executives, but also individuals actually participating in the PFI industry at the point of delivery of the relevant PFI services.

In order to create a “safe space” environment where consultees could feel comfortable enough to provide “unvarnished” and open feedback, all meetings were conducted on the basis that we would not attribute quotes to consultees, disclose the project specific circumstances discussed or produce case studies, but that any feedback given would inform the themes in our report. To the extent that we took notes in any of the meetings that we held, those notes are proprietary to us, have not been shared with any other party and will remain confidential.

In total, we interviewed more than 160 individuals, representing approximately 90 organisations. More than 50% of the organisations that provided feedback to us were Public Sector Stakeholders (as summarised below). The table below summarises the breadth of the public and private stakeholders that provided feedback to us.

Public Sector Stakeholders

- Government Departments
- Devolved Nations
- Local Authorities
- NHS Trusts
- Police Authorities
- Performance Consultants
- Legal Advisors
- National Public Agencies

Private Sector Stakeholders

- Equity Investors
- Debt Providers
- Management Services Providers
- O&M Providers
- Design-Build Contractors
- Legal Advisors

Executive Summary

When considering the status of behaviours, relationships and disputes across the PFI sector we were pleased to encounter widespread acknowledgement (among both public and private sector consultees) that the effective management and delivery of PFI Contracts requires a degree of goodwill and flexibility. It is widely accepted across the PFI industry that this will become increasingly important on the journey to hand back and net zero. We are satisfied that good, professional and productive relationships between Public Authorities and SPVs are a prerequisite to the successful implementation of the remaining term of any PFI Contract.

The PFI industry is, however, at a significant inflexion point. In recent years, a number of Public Authorities have started to manage their PFI Contracts more rigorously. This has involved the relevant Public Authorities moving away from a light touch approach to contract management that relies heavily on cordial relationships with SPVs. For the most part, Public Authorities are resource constrained when it comes to managing their PFI Contracts and so, in that context, a more rigorous approach to contract management should be welcome. However, we received strong feedback from consultees to suggest that the manner in which a number of Public Authorities have implemented their change in approach has often involved overly draconian (if not forensic) enforcement of the terms of the PFI Contract accompanied by, on occasion, unprofessional behaviour. When this approach has been taken by Public Authorities, disputes have typically resulted, relationships have broken down and accompanying goodwill has been lost. More worryingly, we heard stories of how this approach has had a negative impact on the wellbeing of individuals.

Public Authorities should expect their PFI projects to be delivered in accordance with the requirements of the relevant PFI Contract, but evidence suggests that this can be hard to achieve when a Public Authority's own contract management is under resourced. For that reason, we support the provision of greater public

management resource to allow effective PFI Contract management. However, when a Public Authority is considering managing its PFI Contract more rigorously, that decision should be in response to clearly defined strategic objectives (including the manner in which any consultants should be managed), to minimise the risk of unintended (and unwanted) outcomes. If, by taking a more rigorous approach to contract management, the SPV's contractual compliance improves, then this will only be a successful outcome to the extent that it is not eroded by any consequential damage to the relationship between the parties, reduced flexibility and/or goodwill on the part of the SPV or reduction in the SPV's ability to recruit staff to deliver the PFI services.

Our review highlighted that public sector consultees believe that some SPVs have not invested sufficiently in the systems and resources necessary to ensure that self-reporting works reliably. Public Authorities that have introduced more rigour into their contract management shared information with us that substantiated this view. When we dug deeper into this issue, it became clear to us that most SPV Owners can broadly be classified as what we call "industrial" or "financial" SPV Owners, with the former typically managing their assets more proactively than the latter. We recommend that more SPV Owners should adopt the "industrial" owner approach and move away from using cordial relationships with Public Authorities as a proxy for contractual compliance. All SPV Owners should invest appropriately to deliver properly assured performance that can withstand unexpected change or discontinuance.

Without intervention, we expect the current trend towards increased disputes and deteriorating relationships to accelerate. However, based on the feedback that we received from both public and private sector consultees, we are satisfied that there has been historic under management of PFI Contracts by both the public and private sectors and that this collective under management has been to the detriment of the performance of some PFI projects. It is for this reason that we make an overarching recommendation that a "reset" approach be developed jointly by the public and private sectors. A "reset" provides the SPV with an opportunity to deliver assured performance through undertaking (at its own cost) a comprehensive service review and survey of the PFI project, with a time limited window for addressing any issues identified. The Public Authority would agree some relief from Deductions for this programmed approach, thereby incentivising the SPV to take comprehensive action.

We are satisfied that the "reset" approach will provide all parties with not just the opportunity to achieve assured performance of PFI Contracts, but also an opportunity to enrich the relationships and goodwill between them. Some SPVs and/or Public Authorities may, instead, choose to bury their heads in the sand and hope things improve. Our view on this is clear. They won't.

Section 1 - Behaviours are generally reasonable and are not the root cause of disputes

A. Findings

Most contracts have reasonable relationships

1. In our discussions with consultees about behaviours in operational PFI projects, it quickly became clear that most PFI projects continue to benefit from reasonable relationships. SPV Owners and other private sector consultees were able to quantify this across large portfolios. From a public sector perspective, Government Departments and Public Authorities with portfolios of PFI projects shared a similar general view. However, it was clear to us that relationships in particular sectors have deteriorated. Consultees highlighted the health sector, in particular, as having become very adversarial. That experience is causing market participants to be concerned that these behaviours could spread more widely, leading to worsening relationships, associated behaviours and an increase in the prevalence of disputes.

2. In the context of relationships, both the public and private sector believe it is possible to have a dispute in a contract and successfully manage this through to conclusion, without damaging relationships. There was also acknowledgement that this can often not be the case and protracted or badly handled disputes, whether formal or informal, can damage relationships. We deal with disputes in more detail later on in this report.

3. There was a strong emphasis from SPV Owners, Management Services Providers and O&M Providers that they believe that good relationships underpin any flexible approach to effective PFI Contract delivery, especially where services are being provided by the SPV that go beyond those stipulated in the PFI Contract.

4. The overall picture gathered was one of a typical normal distribution with some very good relationships, a strong middle ground of reasonable relationships, some weaker relationships and then pockets where relationships and accompanying behaviours are poor. We spent considerable time with consultees to understand the underlying issues and causes from both a public and private sector perspective. We start with the private sector perspective then balance that with the public sector view.

The private sector perspective

6. From our consultations, it is clear that there are pockets of poor behaviour in the PFI market. From a private sector perspective, the genesis of this is often an overly aggressive interpretation and application of the PFI Contract. Private sector consultees expressed particular concern with this approach when it was led by consultants who weren't adequately managed by their public sector clients.

6. Multiple private sector consultees confirmed many of the practical concerns noted in our brief, as well as others, including:

a. Storing up issues to deluge the help desk with multiple faults in a burst, often timed to achieve maximum commercial impact and disruption rather than to have issues addressed;

b. Prioritising the use of technical and very literal interpretation of specifications in the PFI Contract, seemingly in an attempt to maximise commercial leverage, rather than seek to resolve underlying issues; and

c. Shouting and aggressive conduct during meetings.

7. SPV Owners, Management Service Providers and O&M Providers commented on the personal impact such approaches were having on staff and the associated impact on both recruitment and retention in such circumstances. We heard repeatedly that, in some PFI sectors, it is increasingly difficult to attract high calibre staff, because the employee market considers there to be growing reputational and wellbeing risks associated with accepting particular roles. This is not presently a systemic issue, but there is certainly a risk of it becoming one, particularly if the prevalence of aggressive contract management and associated disputes trends upwards. This is one of the reasons why, later on in this report, we make an overarching recommendation of there being a "reset" opportunity in the PFI market. It is in the public interest for PFI projects to be able to retain and attract high calibre staff .

Private sector not knowing what the "end game" is

8. Where poor behaviours have emerged, many in the private sector have stated that the intention of the public sector is unclear. We repeatedly heard private sector consultees question whether these behaviours were a genuine attempt to improve performance, or an attempt to maximise the level of Deductions that could be made against the Unitary Charge. The belief in the latter is reinforced in private sector opinion by two factors:

a. Reliance on very technical and literal compliance being enforced, even where it is not operationally important to the public sector; and

b. The emergence of consultants that are believed to operate on the basis of contingent fee arrangements that, in whole or part, are linked to the level of Deductions secured against the Unitary Charge.

9. The approach, as reported to us by some in the private sector, felt like an exercise in reducing cost, rather than a structured approach to driving performance up, with the net result being what was described as a spiral of decline in relationships, with money leaking 'out of the sides' of the PFI (ie money being spent on the cost of servicing disputes rather than remedying the issues). Lack of clarity on the end point is unhelpful and we make recommendations later in this report on contract management, to address this point. We also set out below the counter view that we heard from the public sector of significant frustration with issues not being addressed and how a disruption in normal relationships was sometimes needed in order to achieve purposeful engagement.

The private sector view the PFI Estate being held to a higher standard than the non-PFI estate

10. We heard extensive frustration from the private sector that they were frequently being 'penalised' because they were being held to a significantly higher performance standard than the public sector expects in the context of the performance of its non-PFI assets. While we don't dispute that this difference in performance standard exists, we were not convinced that this point was relevant to PFI Contract management and associated relationships. Having spoken to some of the lead players in early PFI thinking, it is clear to us that (for the most part) one of the intended consequences of PFI was to ensure that public infrastructure being maintained under a PFI arrangement would perform to a higher standard than comparable assets being maintained in accordance with traditional arrangements, where budget constraints can lead to delayed maintenance. In fact, some Public Authorities operating large estates of public buildings shared with us (in a positive manner) that based upon apparent condition alone, it can be easy to identify those buildings that are operated under PFI, and those that are not.

11. This issue was made more relevant by some private sector consultees making the point that, in certain cases, service specifications may have been over specified, not just beyond what happens elsewhere in the non-PFI public estate, but also beyond what the Public Authority needs. To the extent that this is a valid point, we believe that it should be dealt with by local negotiation and the contractual change mechanism, if required.

12. Overall, our view was that what happens in the non-PFI estate is not a legitimate justification for failing to meet the specific performance requirements of a PFI Contract.

Pockets of poor behaviours are not one sided – the public sector perspective

13. When discussing behaviours in the PFI market, public sector consultees offered a different perspective to private sector consultees. In the context of those projects where relationships are poor, they gave examples of behaviours on the private sector side that countered some of the behavioural issues raised by private sector consultees. Examples included:

- a. Failing to resolve issues logged on the helpdesk for months and, sometimes, years;
- b. Deliberately withholding critical health & safety information from the relevant Public Authority;
- c. Self-reporting in a “self-serving” manner, with a long history of no, or minimal, Deductions being included in any monthly performance report, despite under performance;
- d. Withholding survey results until all of the survey was complete, even though completed parts could have been made available for release;
- e. Denying access to the public sector to carry out its own surveys; and
- f. Significant prevarication and delay in resolving issues.

In response to the suggestion that the private sector believes the public sector often exercises its contractual rights in an overly aggressive fashion, the typical response from public sector consultees was that this approach was usually only employed after a long period of trying other, less confrontational, approaches. All public sector consultees commented on how, once they employed this approach, they typically experienced a positive step change in the responsiveness of the private sector. The prevailing view of public sector consultees was that “playing hardball” is typically the only way to get the private sector to the table to properly resolve issues.

Private sector underestimates the degree of frustration on the public sector side

14. Even where relationships are reasonable, we encountered a significant degree of frustration among Public Authorities, expressed to us in the following areas:

- a. Variations taking too long and not being addressed with any urgency;
- b. A feeling that SPVs favour resolving commercial issues with their supply chains before addressing the reported issue (referred to by some as “fight first, fix later”), meaning that even obvious faults are sometimes left unresolved for years;

- c. Goodwill being used as a bargaining chip, with the threat of withdrawal of goodwill being used to discourage the Public Authority from exercising its contractual rights;
- d. Self-reporting, which should be a cornerstone of any PFI Contract, not always being as comprehensive as it should be; and
- e. Reassurance being offered on issues when a more rigorous approach to providing assurance is what is needed.

Relationship shifts are often a reaction to unexpected change

15. There appears to often be a correlation between relationships shifting (with greater friction emerging) and changes in key personnel. A number of Public Authorities that had changed the lead person with responsibility for a PFI Contract often commented that their own previous management regimes had been too lax and too cordial, and that they had allowed good day to day relationships to obfuscate the performance picture. As they embarked on a more rigorous approach to contract management, this led to issues being discovered. It is not surprising that this type of tightening of contract management approach may come as a surprise or, indeed, a shock to the private sector, particularly if has been preceded by many years of cordial stability.

16. Similarly, changes in key private sector staff can have an impact on relationships. Examples shared with us on multiple occasions included the private sector suddenly taking a more rigorous approach to reimbursement for malicious damage or charging more for additional services or variations.

Behaviours and relationships are important to flexibility, hand back and net zero

17. There was widespread acknowledgement (among both public and private sector consultees) that managing and delivering long term fixed price contracts, such as PFI Contracts, requires a degree of goodwill and flexibility. It is widely accepted that this will become increasingly important on the journey to handback and net zero. We agree with this observation and believe that good, professional and productive relationships between Public Authorities and SPVs are a prerequisite to the successful implementation of the remaining term of any PFI Contract. Good, professional and productive relationships are in our view, quite distinct from cordial relationships.

Code of Conduct on Behaviours

18. Consultees were asked about the role a code of conduct could play in preventing poor behaviour. Most consultees felt that anything that could serve to improve relationships would be a good thing, but two main caveats were then

typically raised. Firstly, to be really effective, any code of conduct would need to have some level of contractual significance, but that would make it difficult to agree and implement. Secondly, there was concern that when other voluntary codes of conduct had previously been introduced to the PFI market, they had typically only had a short-term impact and that parties had typically deviated away from them as and when they felt that the requirements of the code of conduct no longer served them well. Previous codes of conduct that were quoted included the “Refinancing Code of Conduct” and the “Austerity Measures Code of Conduct”. Other consultees mentioned locally developed “Partnership Charters”, or similar, and reported varying degrees of success.

Overall finding in this section

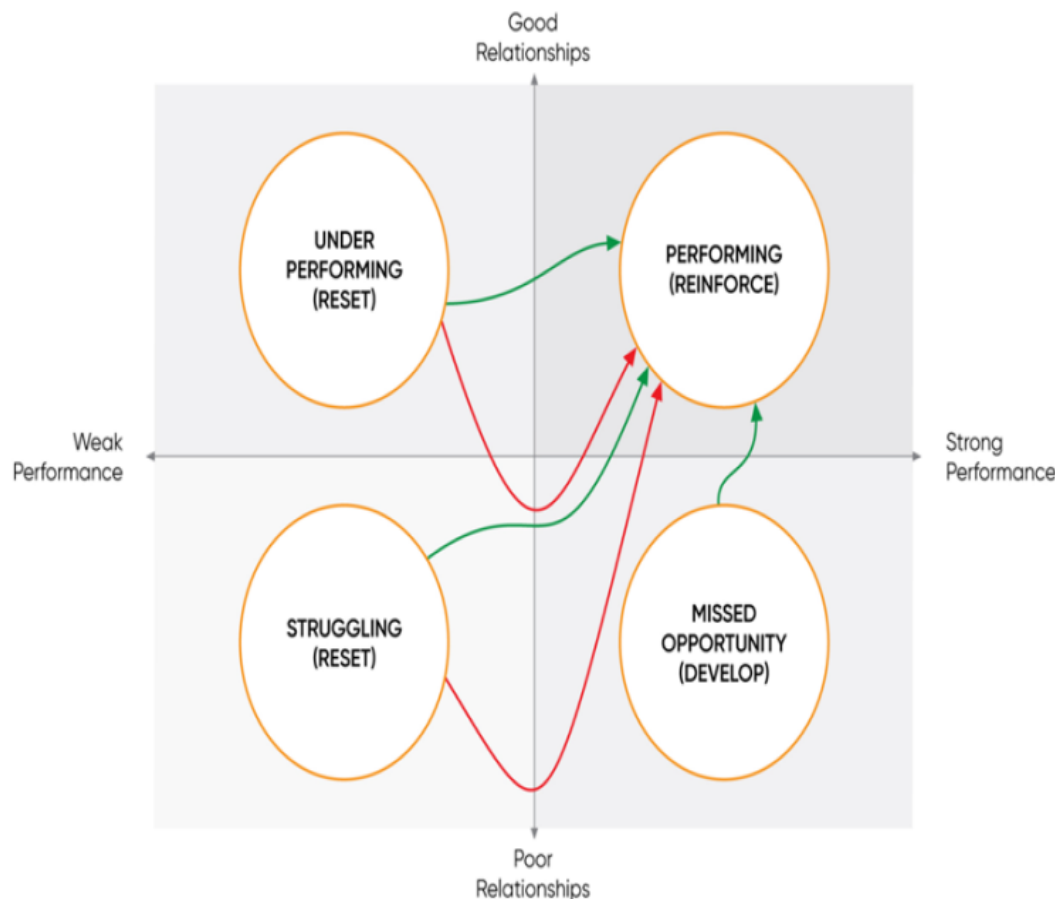
19. Relationships between, and the behaviours of, parties to PFI Contracts are generally reasonable, but with pockets of poor behaviour existing. In our view the pockets of poor behaviour are unacceptable and the public and private sectors should show corporate leadership and be willing to challenge poor behaviour wherever it occurs.

20. Those pockets of poor behaviour may be a proximate cause of some disputes, issues and/or poor relationships, but the root cause is typically an underlying disagreement on the performance of the relevant PFI project.

21. When considering the pathway to achieving stronger performance, the key issue for the parties to consider is the extent to which the chosen route may have a detrimental effect on relationships between the parties. In other words, can a non-confrontational pathway be mapped out, or is a degree of confrontation needed to achieve that performance improvement. This is entirely within the gift of both parties to consciously decide.

22. The chart set out in Figure 1 below summarises the main options for the parties to a PFI Contract when faced with addressing issues of poor performance. Arrows in red illustrate the confrontational pathway that is difficult, where behaviours will suffer, and money will “leak out sideways” on legal costs and disputes. Arrows in green illustrate the pathway where collaboration is maintained on that journey to better performance, with significantly less wasted cost.

Figure 1: Relationships v. Performance in Operational PFI Contracts



23. Any decision on which pathway to take must be a conscious one, to avoid inadvertently slipping into a confrontational pathway. Currently, in our view, too many projects are reported as adopting the “red” route. We believe, and recommend in Section 4 of this report, that the public sector should be willing to incentivise the private sector to improve performance quickly and effectively, by embracing the opportunity to collaboratively “reset” relationships between the parties to PFI Contracts. We also believe that SPV Owners need to be pro-active in creating and seizing that collaborative ‘green’ pathway.

24. Although we did not share Figure 1 with any consultee or disclose to any consultee the identity of any other consultee that we had spoken to, we often received feedback from multiple parties to the same PFI project. When we reflected on this feedback, it was reasonably clear to us that if we had asked each consultee to point to the quadrant in Figure 1 that best described the relevant PFI project, the results would not have been consistent. This highlights a significant perception gap between the parties.

B. Recommendations

25. Given the mixed results that previous codes of conduct have had, we do not believe that introducing a new, bespoke, code of conduct (or Conduct Charter as proposed by DLA Piper in their Project Autumn Report) will be the most effective way of addressing pockets of poor behaviour. We do, however, recommend that greater reliance is placed on "The Seven Principles of Public Life" (also known as the "Nolan" principles), especially the seventh principle, "Leadership", which provides "Holders of public office should exhibit these principles in their own behaviour and treat others with respect. They should actively promote and robustly support the principles and challenge poor behaviour wherever it occurs."

26. In 2013, the Government clarified that any private organisation contracted to deliver public services is subject to the Nolan principles and, accordingly, we believe that "good industry practice" requires any PFI Contractor (and its subcontractors) to operate in accordance with the "Seven Principles of Public Life". We also believe that consultants engaged by Public Authorities should be expected to comply with the Nolan principles. Based on some of the examples of poor behaviour shared with us by public and private consultees, we believe that the Nolan principles are not always being complied with by the public and private sector (and their respective consultants/advisers). We therefore focus here on two recommendations dealing with behaviours:

a. **Awareness of the Nolan Principles** - the IPA, together with Government Departments, should raise awareness of the relevance of the Nolan Principles to the delivery of PFI Contracts; and

b. **All staff engaged in delivering and managing PFI Contracts should be treated with respect** - reports of poor behaviours should be dealt with corporately at a local level, in line with the Nolan Principles, and supply chain members working on PFI projects should be accorded the same respect as public employees. If issues are referred to Government Departments, they should pursue these issues with local corporate leadership.

Section 2 - There is a need for all parties to invest more in contract management

A. Findings

Reporting -v- Monitoring

1. PFI Contracts were intended to be self-reporting. The SPV (and, consequently, the O&M Provider) is typically required to report to the Public Authority each month on its performance against the requirements of the PFI Contract, including a summary of any failures to meet those requirements and any Deductions for that month. This monthly reporting is typically supplemented by periodic reports on issues such as life cycle, forward plans for preventative maintenance and energy consumption. The Public Authority reviews each monthly report and, after resolving any queries, any Deductions for that month are finalised and ultimately deducted from the Unitary Charge.

2. Consultees frequently used the terms self-reporting and self-monitoring interchangeably when describing their PFI project(s). In its 2021 report on managing the expiry of PFI Contracts^[footnote 1], The Public Accounts Committee (PAC) noted “PFI contracts are, in theory, self-monitoring, which means the PFI company is responsible for reviewing performance and reporting back to the authority. Nevertheless, the authority still needs to monitor the PFI company’s performance to ensure it is receiving the services it has paid for”. Likewise, SoPC4^[footnote 2] states “In many cases it will be appropriate for the Contractor to self-monitor, with Authority audit procedures and Authority rights to investigate complaints”. Both the PAC and SOPC acknowledge there is still a need for the public sector to audit/monitor PFI Contract performance.

3. To provide clarity in this report, we deliberately draw a distinction between reporting and monitoring. While we agree that PFI Contracts are in theory self-monitoring (as the PAC report and SoPC sets out), we use self-reporting as the more appropriate term to describe those arrangements under a PFI Contract. This clarity is helpful when considering the need for the public sector to appropriately resource its monitoring/auditing function.

Self-reporting is not always working well enough

4. Both public and private sector consultees shared many examples of good working relationships that benefited from services being delivered well, content end users and robust monthly reports being submitted with, when appropriate, Deductions being made. However, we also heard broad levels of concern from the public sector that self-reporting isn’t working as well as it should, with four principal concerns being cited:

- a. Inspection and management regimes not being thorough enough to pick up all issues;
- b. Issues were not being accurately described in reports;
- c. Complex drafting in service levels agreements often being ambiguous; and

d. SPV Owners and Management Service Providers passing on O&M Providers' reports without any scrutiny.

We also heard from some SPV Owners that in some instances their boards of directors felt that their O&M Providers and Management Service Providers were not sharing information and data with the level of transparency that they would like.

5. The above concerns on self-reporting were typically backed up by sharing specific examples. This was particularly clear in cases where, as highlighted in the previous section, the relevant Public Authority implemented a step change in its approach to contract management. By way of example, we heard several examples of how more active monitoring of the help desk operation (including fault reporting and fault rectification) had highlighted to the relevant Public Authority material insufficiencies in the SPV's (and O&M Provider's) reporting processes. Increased monitoring has highlighted that standards can slip if the self-reporting mechanisms are not properly audited and assured.

Over Reliance on Self Reporting

6. A high percentage of consultees representing Public Authorities and SPV Owners acknowledged that they had previously been too reliant on self-reporting. Feedback suggested that this was often due to resourcing constraints and, in part, a mistaken belief that self-reporting and self-monitoring are one and the same.

Sophistication of contracts and working environment

7. Not only are the requirements of PFI Contracts typically complex but, crucially, they typically need to be managed in a live environment where essential public services are being provided. By way of example, an SPV providing PFI services to an acute hospital will typically need to deliver the requirements of the PFI Contract in the context of a 24/7/365 operating model. This has important practical implications for both public and private staff on the ground. Understanding the precise nature of the services to be delivered, the prioritisation of responses to issues and subsequent reporting is far from straightforward.

8. Consultees shared that the above dynamics could result in those staff delivering services receiving conflicting instructions. By way of example, what is most important to the user of the PFI services at a particular time is not necessarily what the PFI Contract sets as the highest priority. The private sector highlighted concern that in cases where they respond to the Public Authority's operational priorities on the ground, they can run the risk of having Deductions made against them. Other practical issues like obtaining access to an area to carry out a repair or remedy a fault can cut across the Public Authority's operational priorities at that time. Collaboration (including a degree of contractual flexibility) and judgement are often necessary to resolve such issues. If a Public Authority (or its advisers) takes

a very rigorous, and literal, approach to managing its PFI Contract, there is a risk that some of that operational flexibility could be lost, as the approach would force the SPV (and its O&M Provider) to focus on pure compliance, rather than responding to local needs. Several O&M Providers shared with us that they have been forced to prioritise contractual compliance over serving local needs, as a result of being exposed to situations like the examples mentioned above.

9. O&M Providers and Management Service Providers emphasised that the judgement required to address issues of local prioritisation and how best to deliver the service to support the Public Authority's wider operations, requires knowledgeable and experienced staff on both sides. Public and private sector consultees highlighted how it is becoming increasingly difficult to retain and attract staff with either sufficient experience of these complex contracts, or a desire to learn about them. Consultees working in the health sector described these issues as "toxic", causing us to question whether the manner in which PFI Contracts are managed is always mindful of the potential effect that a particular approach may have on the wellbeing of public and private frontline staff.

Approach by SPV Owners

10. In our consultations with SPV Owners, we were struck by the differing approaches and outlooks of the various investors. Some SPV Owners clearly approach their role more as the owner of a "financial asset" and others more as the owner of an "industrial asset". There is, of course, a spectrum of outlooks rather than two absolute views, but we use these terms here to broadly describe two different types of approach.

11. Those that have more of a financial asset ownership approach will tend to have 'thin' or lightly resourced SPVs, and be more reliant on self-reporting by the O&M Provider. A number expressed the view that, 'everyone knows that PFIs have thin SPVs as part of the model'. This was asserted almost as if it was an embedded contractual obligation rather than an approach or a choice by the SPV Owner. Thin SPVs can be an effective approach and a reasonable choice but adopting this approach is reliant on the assumption that all aspects of the PFI Contract are working reasonably well. When there are issues or problems, thin SPVs need to be strengthened to deal with those issues or problems. The financial asset ownership approach relies very much on its contractual links to its supply chain and therefore problems are allocated to be owned in the supply chain rather than at SPV level. This was referred to by many we spoke to as the "Teflon tube" approach, with nothing "sticking" at SPV level. This approach can contribute to the frustrations expressed by the public sector (as summarised in the previous section) with respect to issues going unresolved until contractual skirmishing with the supply chain has been resolved – ie the "fight first, fix later" approach. The financial asset ownership approach tends to rely more on this "thin" approach, providing reassurance to Public Authorities, rather than assurance.

12. Those that have more of an industrial asset ownership outlook expressed much greater ownership of issues and the willingness to invest in order to manage and resolve issues. This typically meant putting more resource into SPV management or tackling issues at an SPV level, rather than always relying on resolving matters with the supply chain first. The SPV Owners that expressed these views were by no means stating an altruistic approach, but took greater corporate responsibility for the business they owned with a view to long term business sustainability.

13. Interestingly, those Public Authorities that deal with multiple SPVs were able to clearly define these two different approaches and point to examples of why certain investors fell into each category. It was very apparent to us that Public Authorities are generally much more comfortable dealing with SPV Owners that fall into the “industrial owner” category. Examples given included how very thinly resourced SPVs were effectively excluded from technical discussions on key issues because they lacked sufficient expertise, or thin SPVs dismissing their lead responsibility by categorising it as the responsibility of their O&M Provider. This is not a uniform picture and other SPVs were better resourced, with some clearly having very strong in-house technical expertise. Feedback from O&M Providers reinforced the view that SPV Owners broadly fell into either the “financial owner” or the “industrial owner” category.

14. There are many reasons why differing approaches to SPV management exist, including local resource, investor philosophy, reducing SPV management budgets as an efficiency measure, and well-functioning SPVs not needing significant resource in order to operate efficiently. However, we would recommend that all SPV Owners reflect on the effectiveness of their operating models in light of the following observations, because the case for improvement is clear:

a. Despite feedback that we received from some consultees representing SPV Owners, we do not believe that it is realistic for SPV Owners to expect to have only a minimal role in the day-to-day operations of a PFI project. The public sector provided us with strong evidence to suggest that (i) Public Authorities are highly appraised of the financial wellbeing of SPV Owners; (ii) the frustrations described in paragraph 14 of Section 1 are growing; (iii) the perception gap on performance highlighted in paragraph 24 of Section 1 should be a concern; (iv) the concerns on self-reporting summarised earlier in this section are real, and (v) there is an inextricable link between the strength of relationships and the level of direct engagement that SPV Owners have with their public sector clients. We noted with interest that those PFI projects where the Public Authority had a seat on the board of the SPV seemed to enjoy greater levels of transparency and a more open approach to resolving operational issues;

b. Whenever we asked consultees representing Public Authorities to name the SPV Owners and/or the names of the directors of the SPV, substantially all of

them did not know. When they were able to name one or more SPV Owner, they typically referred to them as “the funders”;

c. Although all of the consultees representing Public Authorities could name the representative of the Management Services Provider engaged in their project, they often commented that representative had very limited jurisdiction to resolve issues; and

d. When the relevant Public Authority felt that it was raising a reasonable issue, we were told that the representative of the Management Services Provider sometimes stated that pursuing the issue, even though correct from a contractual perspective, wasn't representative of a partnering approach and that if the issue was pursued further, it would erode the SPV's goodwill when the Public Authority needed some degree of flexibility from the SPV in the future (eg with respect to expedient execution of a variation).

Public Sector Resourcing

15. We heard from many Public Authorities that they know they are under resourced to manage their PFI Contracts and that they are doing the best job they can with the limited resources that they have available. Stronger resourcing tends to exist where the PFI asset is more complex or forms a large part of the Public Authorities' estate. Resourcing is more stretched elsewhere, either because PFI is a small element of the overall estate or because the PFI Contract is being managed in an era of tight budgets and PFI Contract management has not been prioritised. The fact that there is a perception that these contracts are self-monitoring has, in our view, added to the lack of resource in this area, with those making budget allocations reported as cutting resources on the mistaken basis of “not needing to allocate budget to fund the monitoring of a self-monitoring contract”.

16. The public sector resourcing challenge is an ongoing issue. Some examples of recent comment include:

a. The Public Accounts Committee 2021 report into PFI expiry^[footnote 3] commented, ‘Many authorities currently lack the skills, expertise and capabilities to successfully deliver PFI contract expiry, with locally managed contracts most at risk’; and

b. The NAO 2020 report into managing PFI assets and services as contracts end^[footnote 4] stated, ‘develop an approach to identifying high-risk projects, such as those sitting with authorities that lack appropriate skills and capabilities. The IPA and departments should work with public sector stakeholders to assess how skill shortages can be addressed’.

While these recent reports were written with a focus on expiry, we heard that resourcing is a wider day-to-day operational issue, with some describing a “hollowing out” of public sector asset management capability that has evolved over time.

17. Even where SPVs perform well or SPV Owners step up to improve performance (as suggested above), Public Authorities should not treat PFI Contracts as if they are self-monitoring. As stated earlier in this report, they are self-reporting contracts, but not self-monitoring. SPVs should be fulfilling their obligations to self-report, but even where that is the case, Public Authorities should (as highlighted by The Public Accounts Committee) nevertheless be monitoring the SPV’s underlying performance. In other words, it is the Public Authority’s responsibility to monitor and audit performance, including both the substance and the form of the monthly reports that it receives from the SPV.

B. Recommendations

18. Given the sophisticated contract structures outlined above, and the consultees views on self-reporting, we believe additional resource is required by SPV Owners and the public sector to manage PFI Contracts. This is essential to achieve the accountability, goodwill and flexibility that should exist in a good productive relationship. That not only requires a foundation of solid assured performance from SPV Owners, but it also requires the public sector to use judgement on how best to incentivise performance improvement by striking compromises that provide a wider benefit to the Public Authority’s operational priorities. However, this requires capacity and capability. We acknowledge the budget challenges that many public bodies are facing but under resourcing contracts of this scale and complexity is a risk. We make four recommendations with respect to strengthening management approaches:

- a. An Industrial Ownership Approach - We recommend that more SPV Owners adopt the “industrial owner” perspective already exhibited by some in the market. Good relationships must be productive, not just cordial, and be built on a bedrock of assured performance.
- b. Manage out the Unnecessary Frustrations - Routine matters such as smaller variations need to be dealt with in a faster and more user focused way. It is understandable that some complex issues require detailed consideration, but others are capable of being dealt with more efficiently. We recommend that there is concerted effort between SPV Owners and Debt Providers to streamline more routine matters. This is a source of great frustration across the public sector and, if left unchecked, this will continue to be a drag on relationships.

c. **Public Authorities need to Monitor and Manage** - All Public Authorities should recognise that PFI Contracts are, at best, self-reporting; they are not self-monitoring, and Public Authorities should approach PFI Contract management in a manner that recognises the need for active performance monitoring to be undertaken. This includes each Public Authority having the capability to implement its own auditing and assurance on performance, reporting and compliance. This is a local, rather than a central, responsibility. It is important now for successful day to day operational management and will only become increasingly important as hand back approaches.

d. **Consistency of Approach** - sponsoring Government Departments should consider providing increased centralised resource to assist the Public Authorities that they fund in the management of their PFI Contracts. To the extent that the public sector can improve the consistency with which its PFI Contracts are managed, we would expect this to result in a material reduction in both the number of disputes that arise across the PFI estate, and the amount of time that executives of relevant Public Authorities spend managing disputes. Active Public Authority management should be reinforced by networks or portfolio approaches to share information and good practice. Good examples exist and these should be strengthened and extended. Government Departments should reflect on their PFI portfolios and ensure that appropriate arrangements are in place.

Section 3 - Disputes are using up too much valuable resource

A. Findings

1. Given the background to our report, we anticipated that we would be faced with an overwhelming amount of evidence to suggest that formal disputes are now not only commonplace across the PFI industry, but also that the level of trust between the public and private sectors was fundamentally eroded. In actual fact, many PFI Owners, Public Agencies and Government Departments reported to us that formal disputes (ie adjudication, arbitration or litigation) are still very much the exception, rather than the norm. Feedback has, however, allowed us to reach some broad conclusions with respect to the prevalence of disputes across the PFI market, including:

a. At any point in time, we estimate that the number of PFI projects engaged in disputes makes up less than 10% of the total number of operational PFI projects;

and

b. Of those PFI projects that are, at any time, working through disputes, we estimate that less than 10% of them are referred to formal dispute resolution. The majority of disputes are typically resolved through negotiation and/or mediation.

The above estimates are not representative of the landscape in each PFI sector, however. As highlighted elsewhere in this report, the prevalence of disputes in the health PFI sector is now significantly higher than the broader PFI industry norm and this has consistently trended upwards over the last ten years. Feedback from all consultees engaged in health PFI projects has caused us to conclude that this trend has arisen as a direct consequence of an increasing number of relevant Public Authorities choosing to manage their PFI Contracts more robustly than they have in the past and, in particular, the strategies that those Public Authorities have (consciously or not) taken with a view to resolving failures by the relevant SPVs (and their supply chains) to deliver the relevant services in accordance with the requirements of the PFI Contract.

2. We encountered a significant level of anxiety on the part of the private sector that the approach to contract management increasingly being adopted by Public Authorities in the PFI health sector may, over time, begin to be adopted in other PFI sectors. When we probed deeper into this concern, it was clear to us that the private sector doesn't have any issue with Public Authorities committing more resource to the management of PFI Contracts (we actually encountered a broad level of opinion in the private sector that Public Authorities have not, historically, typically been able to effectively resource PFI Contract management). The anxiety associated with increased contract management is fuelled by a concern that in the context of Public Authorities managing their PFI Contracts more robustly, the focus will quickly be on punishing the relevant SPV for any historic under performance that is discovered, rather than a focus on ensuring all round better performance.

3. It should not be surprising that, during the life of a long-term sophisticated contract, the parties will encounter disputes. Despite the significant time spent negotiating the terms of PFI Contracts, it would be unrealistic to expect any PFI Contract to foresee every eventuality that will arise during its term. PFI projects can only be a success if both parties work collaboratively together and create the level of "trust" and "goodwill" that will allow the PFI project to successfully navigate all of the changes that it will inevitably encounter through its life. Evidence that we gathered suggests that some level of breakdown in trust or perceived lack of goodwill is typically either a prerequisite to any formal dispute and/or, unfortunately, a consequence of the relevant dispute.

4. The prevailing view across the PFI market appears to be that formal dispute resolution should be used as a last resort, on the basis that it is often expensive, inefficient and/or damaging to future relations between the parties. Of those consultees that had been involved in disputes, we often heard feedback that

suggested some level of regret associated with being involved in a lengthy and formal dispute. We consistently heard of “wasted time and effort”, “missed moments in time to resolve the issue” and “only serving to take scarce money away from the project” as ways of expressing such regret. Although any level of regret is sub-optimal, these experiences are important lessons learned for the broader PFI industry, especially in the context of the expiry and handback of PFI projects, where the prevailing view across the PFI industry is that there is significant scope for disputes due to lack of contractual definition with respect to the condition that PFI projects are required to be in at expiry.

5. Some Public Authorities also expressed regret at not referring particular issues for formal dispute resolution. Typically, this was because the relevant Public Authority felt that it had a strong case, but lacked the resource or corporate bandwidth to pursue a dispute more fully. This was more an expression of regret at conceding on an issue that they felt they would have prevailed on, rather than a desire to engage in a formal dispute process.

6. Notwithstanding the evidence to suggest that only a minority of PFI projects have encountered major disputes, we did hear broad concern across the PFI market that the prevalence of disputes is increasing. That is not to suggest that we believe the percentage of disputes being referred to formal dispute resolution is increasing; it is the frequency with which disputes are arising, generally, that is trending upwards. We also heard concerns that the current environment is creating a lucrative and self-perpetuating disputes advisory market. Public and private sector consultees involved in the health sector frequently expressed concern that advisers are, when engaged, increasing distance between the commercial parties and often advising their clients with a view to winning the current dispute “at all costs”. We deal with this issue more fully in the next section.

7. When sharing regrets or “lessons learned” with us, consultees frequently commented that one of the consequences of entering into a lengthy and formal dispute had been some degree of breakdown of the relationship between the parties, which often caused those parties (with the benefit of hindsight) to recognise that they had undervalued the benefit of using a dispute to invest in the value of goodwill and trust between the parties. “Life after a major dispute” had been particularly difficult for a number of consultees because one or both parties had thereafter managed the PFI Contract in a strictly contractual (rather than relational) manner, leading to a significant reduction in the willingness of the relevant party to “go the extra mile” or find solutions to unforeseen changes in circumstances. Several Public Authorities considered this a sub-optimal outcome, particularly when they subsequently realised that they needed to rely on the goodwill of the relevant SPV to more readily navigate through significant issues arising during the remaining term of the PFI Contract (eg transitioning to carbon neutral targets, handback/expiry and/or addressing future needs with respect to service configuration).

8. A number of Public Authorities highlighted evaluative mediation as an effective approach to resolving disputes, which they felt was not just quicker and less costly than adjudication, but also a useful reality check for both parties with respect to the strength of their respective cases. Unlike with facilitative (or traditional) mediation, where the role of the mediator is principally to engage the parties to generate their own solutions, evaluative mediation is more directive, with the mediator providing both reality testing and settlement recommendations. Although evaluative mediation is often criticised for not being neutral in its approach (because the mediator may favour one party's argument) those Public Authorities that highlighted the effectiveness of this approach felt that it was particularly effective where both parties already felt that they had a "cast iron" case against the other and that they should not settle for anything less than they were asking for.

9. When we requested feedback on why formal dispute resolution was considered inefficient and/or sub-optimal, two comments were often made by consultees:

a. As a result of most PFI Contracts having standardised contractual terms in common, there should be no need for the same disputes to arise time and time again across multiple PFI Contracts, especially if those disputes relate to the interpretation of the same contract provisions. Yet this is the reality. As a result of most disputes typically being resolved through private adjudication processes, one party sharing the outcomes of a dispute with a third party will typically constitute a breach of confidentiality undertakings given to the other party to the dispute. In practice, this has had two effects on the PFI market:

(i) Significant public and private funds have often been spent disputing the same issue time and time again; and

(ii) There is an asymmetry in the level of knowledge sharing across the public and private sectors, with the private sector typically benefiting from a significantly greater level of knowledge sharing due to the higher level of consolidation of SPV ownership, O&M Contractors and Management Service Providers relative to Public Authorities. For example, we spoke to Government Departments that are not privy to the outcomes of disputes across the PFI Contracts entered into by the Public Authorities that they fund, due to concerns that the relevant Public Authorities would be in breach of contract if they shared the relevant information.

Reassuringly, there was broad recognition that it was in the best interests of the PFI market (as a whole) for the outcomes of formally adjudicated disputes to be made available, on an anonymised basis, to the broader market.

b. There is a general lack of confidence in the ability of the current stipulated panels or professional dispute resolution bodies to recommend adjudicators with appropriate levels of expertise and knowledge relative to the operation of PFI Contracts. Several consultees shared stories of how, despite the parties referring

a dispute to formal dispute resolution, several issues still required negotiation following conclusion of the process, because the relevant adjudicator was not sufficiently qualified to hear the dispute or certain aspects of it.

10. When we asked consultees if they were concerned about any issues that could give rise to future disputes, there was broad concern that there could be scope for significant disputes during the period running up to the expiry of the PFI Contract (typically referred to as the “handback” period), particularly in the context of those PFI projects that are due to expire in the next 5-10 years and don’t necessarily have clear contractual provisions relating to the condition of the asset when it is handed back to the Public Authority .

11. Finally, we were specifically asked to consider the establishment of an “Expiry and Handback Resolution Council”. As set out in DLA Piper’s Project Autumn Report, this would be mandated to determine disputes relating to expiry and hand back. We see value in these proposals, although we would not limit the scope of the Council’s “jurisdiction” to hearing just handback disputes (see our recommendations below).

B. Recommendations

12. Anything that can be done to reduce either the number of disputes in operating PFI Contracts, or the percentage of disputes being referred to formal dispute resolution is, in our view, in the public interest. It is also in the best interests of both market efficiency and efficient use of public funds. We make three recommendations in this regard:

a. PFI Dispute Resolution Forum - given how many operational PFI projects there are that will not expire for many years to come, and that PFI Contracts are unique and inherently complex, we believe that there are very compelling reasons why the PFI Industry should seek to ensure that all disputes are heard and determined consistently. In particular, it is imperative that the PFI industry begins to benefit from a meaningful bank of jurisprudential precedent that is publicly available.

For the most part, PFI disputes are (in accordance with the terms of the relevant PFI Contract) being heard privately by adjudicators. However, this approach is, in our view, flawed for two key reasons:

(i) The complexity of many PFI disputes is often beyond the experience and capabilities of the adjudicator, resulting in poor decisions; and

(ii) Adjudicative decisions are private, meaning that jurisprudence is playing less of a role in the evolution of the PFI market than it should be. Significant time and

money is being wasted across the PFI market due to the same disputes being heard time and time again,

In its “Project Autumn” Report, the law firm DLA Piper highlighted these flaws in the context of concerns related to the number of disputes that may arise with respect to the expiry and handback of PFI projects. In its report, DLA Piper recommended the creation of an “Expiry and Handback Resolution Council” that would be used, across industry, to hear disputes related to expiry and handback. The recommendation suggested that the Council should consist of five leading adjudicators/arbitrators with experience of PPP and PFI Projects and that a “Chair” should be elected to manage referrals and to advise on structure and format. By agreement of the parties to a PFI Contract, disputes would be referred to a member (or members) of the Council to ensure that an element of consistency could be developed and monitored across the board.

Although we support DLA Piper’s recommendation, there are three key enhancements that we would make to that recommendation:

(i) A “PFI Dispute Resolution Forum” should be established that has jurisdiction to hear any type of PFI dispute (not just disputes relating to handback and expiry). It is clear to us that the PFI Industry is in dire need of this;

(ii) Given the technical complexity associated with so many PFI disputes, adjudicators should be able to call for support from non-legal PFI experts (eg engineers and financial advisors) that are accredited by the PFI Dispute Resolution Forum; and

(iii) The establishment of the PFI Disputes Resolution Forum should not come at the cost of the promotion of the use of mediation by parties to disputes. There will be a significant administrative role associated with the establishment of the PFI Dispute Resolution Forum and, as part of that, we would recommend that a database of fully accredited “PFI mediators” is developed, so that parties to disputes have access to mediators with relevant experience and skills.

The establishment of the PFI Dispute Resolution Forum will provide the following benefits to the PFI industry:

(i) Anonymised versions of adjudicative decisions will be made publicly available, thereby allowing a body of “PFI common law” to develop and help reduce the inefficiencies that are created by the same disputes being referred to private dispute resolution forums time and time again;

(ii) The quality of decisions should improve if members of the PFI Dispute Resolution Forum have access to non-legal PFI experts; and

(iii) By making a bank of accredited mediators available to the PFI market, less disputes should be referred to adjudication.

b. Access to Information - Government Departments must have access to information related to any disputes in operational PFI Contracts entered into by the Public Authorities that they fund, including the decisions of any formal adjudication processes. To the extent that information is not flowing to relevant Government Departments due to legal issues, then this should be investigated and addressed as a priority. Until such time as this issue is addressed, we have real concerns that the management and leadership of disputes by Public Authorities will be increasingly outsourced to advisers, on the basis that they have visibility of other disputes in the market that they are involved in. To the extent that Public Authorities are being advised that disclosure of an adjudicative decision to a sponsoring Department or the IPA would represent a breach of confidentiality, we would encourage the relevant Public Authorities and sponsoring Departments to strongly challenge that advice and, if necessary, approach the relevant SPV for confirmation that they have no objection to such disclosure. Based on feedback from consultees, we do not believe that the private sector has any objection to Public Authorities sharing the details of the outcomes of formal dispute resolution processes with sponsoring Government Departments; in fact, we received strong support for this.

c. Contingent Fee arrangements – given the complexity of many disputes relating to PFI disputes, Public Authorities may often need to supplement their internal resource by engaging external advisers. This can be a positive step given the lack of internal public sector resource available. We do, however, feel strongly that, in such circumstances, Public Authorities should not engage their advisers on the basis of contingent fee arrangements. In the context of a major PFI Contract dispute, it is imperative that all decisions are made on the basis of what is in the best public interest and, in our view, contingent fee arrangements can run the risk of compromising this principle (eg achieving the highest financial settlement isn't always in the best public interest).

Section 4 - A clear contract management strategy can minimise the risk of unexpected outcomes

A. Findings

Communicating intended change is critical to the success of any relationship

1. When we spoke to Public Authorities and Government Departments that had significantly ramped up their approach to contract management, it was unclear whether compliance, better performance or Deductions was the main aim of that increased focus. The apparent lack of clear reasoning for the change was interesting to us, because on each occasion that we spoke to a consultee that had been engaged in a major dispute, it often quickly became clear that the genesis of the dispute could be traced back to some form of change in approach to contract management introduced by the relevant Public Authority. That change could be as simple as the change in identity of a contract manager, the engagement of third party consultants to assist in the management of the PFI Contract or a different level of interest in the management of the PFI Contract being shown by an executive officer of the relevant Public Authority or Government Department.

2. Interestingly, private sector consultees did not come across as being adverse to Public Authorities changing their approach to contract management. In fact, it is clear to us that those Government Departments and Public Authorities that have well resourced, proactive and robust approaches to contract management are held in high regard by the private sector and seen as a blueprint for success. So why, then, has a change in approach to contract management so frequently marked the commencement of a dispute or series of disputes between the parties?

3. Universal feedback from the private sector is that when a Government Department or Public Authority changes its approach to contract management, it is not unreasonable for the private sector to assume that the change in approach is being made in response to a concern that the relevant Government Department or Public Authority has. The private sector's criticism of the public sector is that when a change in approach to PFI Contract management is introduced, it rarely comes with any explanation or reasoning, making it difficult for the private sector to understand what the problem is that the public sector is trying to solve. "Is the change in approach triggered by a concern about our performance? Does the client believe that it is being too soft on us? Is there a desire to try and create a revenue stream from making Deductions under the Payment Mechanism? We just don't know and often the change in approach happens after many years of the PFI Contract being managed in a particular way - a way that we had no reason to believe the public sector was unhappy with."

4. Based on the feedback that we received in relation to situations where the relevant Public Authority or Government Department had increased its level of contract management, we quickly reached the following conclusions:

a. When a Public Authority starts to take a more robust approach to managing its PFI Contract, it doesn't typically inform the SPV of its change in approach. This is

noteworthy, because whenever a party wishes to make a change to how it approaches a relationship, that change will often only have a positive effect on the relationship if the party making the change also recognises the importance of communicating that change (and the reasons for it) to the other party;

b. The best way to find something is to look for it. For that reason, when a Public Authority places increased focus on how it manages a PFI Contract, it is inevitable that it will find something that it wasn't previously aware of. Based on private sector feedback, what the Public Authority then does with that new information is often not only the first indication of why the Public Authority increased its focus on contract management in the first place, but also the decision that will determine the likelihood of a dispute ensuing between the parties; and

c. Given that self-reporting is a central feature of any PFI Contract, it can be easy for the public sector to interpret any such new information as a fundamental failure in that self-reporting regime and seek to find ways of punishing the private sector for that failure, rather than addressing the underlying issue flagged by the new information. Based on feedback from consultees, we do have a concern that when a Public Authority discovers new information with respect to the PFI Contractor's performance, the relevant Public Authority can often become preoccupied with concerns about what the PFI Contractor has historically been "getting away with", rather than focusing on how to address the issue going forward. When this happens, some level of dispute between the parties not only appears to be inevitable, but the private sector interprets this to mean, rightly or wrongly, that the principal aim of the increased focus on contract management was to find ways of penalising the SPV and make Deductions from the Unitary Charge, rather than improve the quality of contract compliance audits or the underlying performance of the PFI Contract. That is not to suggest that the reasons for the relevant issue not being self-reported should not be investigated, but rather that the primary focus should be rectification of the relevant issue and that (in the context of trying to understand why the relevant issue hadn't been previously self-reported) the Public Authority should give consideration to whether the SPV's (and/or its O&M Contractor's) failure to self-report was either a deliberate attempt to withhold information, or a consequence of the SPV (and/or its O&M Contractor) not being aware of the relevant issue.

It is critical to understand what a "win" looks like and to recognise that a good "win" can address "needs", rather than "wants"

5. To the extent that disputes arise as a result of how a PFI Contract is being managed, both parties would be well advised to consider what a "win" would look like in the context of resolving that dispute. Ideally, that analysis would be undertaken at the outset of any dispute, well in advance of expending the significant time and money that can be required by a major dispute. Performing this analysis can often be very challenging though, because it forces the relevant

party to contemplate making concessions and focus on what it “needs”, rather than what it “wants”. A number of consultees shared with us examples of very long disputes and their views as to why the dispute had not been resolved much earlier. Feedback suggested that for some parties (especially the public sector), making the decision to continue pursuing the dispute can often be easier than reaching compromise through negotiation, perhaps because relying on a third party (eg an adjudicator) to settle a dispute is less open to public scrutiny than the details of a negotiated settlement. We also received feedback from the public sector to the effect that the private sector is often quick to involve legal advisers at the very outset of disputes, which from the public sector’s perspective, has the effect of making the dispute feel immediately adversarial and can result in the parties losing the opportunity to reach a commercial resolution.

6. Some consultees shared that, with hindsight, they wished they had worked harder to settle their dispute, rather than let it run the full course. Interestingly, when consultees shared these comments with us, we got the strong impression that any regret was perhaps more a reflection of the fact that the outcome of the formal dispute resolution process was unexpected, rather than that they considered any marginal benefit achieved by continuing with the dispute as not being worth the time and cost that needed to be invested.

7. The feedback from consultees has caused us to conclude that it is more the exception, rather than the norm, for Public Authorities to analyse in advance of commencing disputes, what a good outcome would look like. The problem with not undertaking this analysis is not only that the scope for unexpected outcomes is increased, but also that there is no “playbook” from which the dispute can be managed, increasing the risk of inefficiency and wastefulness in terms of time and money. As noted elsewhere in this report, the significant majority of disputes are settled through negotiation; however, many of those settlements are reached at the “11th hour”, to avoid the uncertainty associated with relying on a third party to resolve the dispute. To the extent that formal dispute resolution should be seen as a last resort, then the objective should be to increase the number of disputes that are resolved in advance of any formal dispute resolution process being commenced. Achieving this objective is invariably only going to be possible to the extent that relevant parties have a clear strategy at the outset of any dispute, as well as a good sense of what the range of outcomes could be and an understanding of which of those outcomes would be “optimal”, “sub-optimal” or “unacceptable”, recognising that “sub-optimal” outcomes are not necessarily “bad” outcomes.

Disputes are more likely to end with poor relationships and less flexibility if commenced without clear vision

8. Although it is inevitable that disputes will arise during the life of a long-term PFI Contract, a well managed dispute can actually be value accretive to a relationship,

rather than value destructive. Based on feedback from consultees, however, we found little evidence of situations where the parties had been brought closer to each other as a result of a dispute. Our overwhelming conclusion is that the majority of consultees that had been party to a long, major dispute came away feeling that the process had been inefficient, unduly expensive and lacking in pragmatism. We often heard consultees express concern that “value had been lost from the project” as a result of the dispute and, on further enquiry, it became clear that this comment was either referring to the amount of time and money that had been spent by all parties on legal costs, and/or the erosion of trust/goodwill between the parties that had arisen as a consequence of the relevant dispute. Consequently, we encountered numerous public and private sector consultees that had lost respect for their PFI Contract counterparty because of how they felt about how the other party had managed the PFI Contract. We have concluded that long-term disputes are typically detrimental to the relationship between the parties to a PFI Contract.

9. By definition, PFI Contracts are long-term, relational contracts. In order for them to work well, there needs to be some level of flexibility between the parties and a collaborative relationship. However, in the absence of a certain level of goodwill and trust between the parties, this can be very difficult to achieve. Disputes are clearly a threat to any PFI relationship and parties to potential disputes should be alive to this. When a dispute is finally resolved or determined by a third party, the various advisers will disappear and the commercial parties will be left to work together for the remaining years of the PFI Contract. It was discouraging to hear so many stories of how, as a result of a long term dispute between the parties, the PFI Contract had become difficult to administer and that one or more parties to the PFI project had “doubled-down” on managing the PFI Contract to the letter of the contract, without any desire to work relationally with the other parties.

B. Recommendations

10. We are satisfied that a clear strategy behind any particular contract management approach is essential to avoid unexpected outcomes and unnecessary erosion of goodwill and/or trust between the parties. We would recommend all Public Authorities and Government Departments to consider the following points before either implementing changes to contract management approaches, or commencing a dispute:

a. Addressing poor performance with a strategic goal – to the extent that a Public Authority believes that its PFI Contractor is under performing, it is important for that Public Authority to understand what its rights and remedies may be with respect to that under performance, but it is just as important (if not more

important) for the Public Authority to have a clear understanding of (i) what a “good” outcome would look like; and (ii) its strategy for achieving that outcome. In our view, a Public Authority should not assume that the “best” outcome will always be achieved if it expeditiously exercises its contractual rights and remedies. The better approach is for the Public Authority to finalise its strategy and then determine the extent to which its contractual rights and remedies can be used to help deliver that strategy. Further, if the Public Authority sees value in maintaining (or improving) the level of trust and/or goodwill between the parties for the remaining term of the PFI Contract, a good strategy would be put together with that in mind.

b. Relational -v- Penal – when considering its strategy for achieving any outcome associated with the improvement of the performance of a PFI Contract, Public Authorities should consider the different routes that can be taken towards achieving that outcome and, in particular, the pros/cons of using the PFI Contract to penalise the PFI Contractor for its performance, as opposed to using the PFI Contract to incentivise the PFI Contractor to improve its performance. Although every situation should be judged on its merits, as a general rule we believe that taking the approach of using the PFI Contract to incentivise the PFI Contractor is the better one, particularly if the Public Authority aspires to moving the PFI project into the “Reinforce” quadrant of the Performance -v- Relationship graph shown in Figure 1 set out in paragraph 22 of Section 1 above. This judgement will also be informed by the culture and approach of the SPV Owners. A relational approach is, in our view, more likely to be successful where the SPV Owner has an “industrial owner” outlook (see paragraphs 10-14 of Section 2 above).

11. Based on the feedback that we received from both public and private sector consultees, we are satisfied that there has been historic under management of PFI Contracts by both the public and private sectors and that this collective under management has been to the detriment of the performance of some PFI projects. It is for this reason that we make the following recommendations with respect to the joint development of a “reset” approach by the public and private sectors:

a. Encourage good behaviour by creating a “reset” environment – consultees appraised us of various attempts across the market to introduce the opportunity for parties to undertake (by way of third party technical surveys) audits of operational PFI Contracts, with a view to the PFI Contractor then having a reasonable period of time to remedy any issues highlighted by those surveys. Provided those issues are adequately addressed within a reasonable period of time, the Public Authority would provide some level of relief from any associated Deductions, much like in the same way that relief is typically granted in respect of Deductions associated planned preventative maintenance. We recommend that these approaches be further developed (and sponsored) by the IPA, Government Departments and SPV Owners, with a view to this approach becoming a

cornerstone of the opportunity for the PFI market to “reset” itself. This recommendation is discussed in more detail in Section 5 of this report.

b. Urgency needed in most stressed sectors – Government Departments in sectors where relationships are more adversarial, such as health, should consider a “reset” approach as a matter of urgency, provided the private sector is equally willing to embrace this approach.

Section 5 - There is a “reset” opportunity in the PFI market

1. Sections 1-4 of this report have set out a series of findings and recommendations. If implemented, they will improve behaviours and relationships considerably. This section sets out more detail on one of our key recommendations – the “reset” approach. The “reset” approach represents an opportunity for a more fundamental overhaul of relationships across the PFI sector. Although this may sound bold, we believe such an overhaul is long overdue.

2. A type of “resetting” appears to be currently taking place in the health sector, although this seems to typically occur against a backdrop of the relevant Public Authority ramping up inspections and audits that have often led to some level of confrontation and break down of the relationship between the Public Authority and the SPV. As highlighted earlier in the report, this approach has been seen by some Public Authorities as being the only way to get a meaningful response from the SPV, albeit that it often leads to tense relationships and disputes, with wasteful pain and cost for all parties. We heard repeatedly from the public and private sectors that the confrontational approach soaked up too much scarce executive leadership time and typically required significant levels of external costs to be incurred.

3. The “reset” we are recommending represents an opportunity for the parties to move a PFI project into the “Reinforce” quadrant identified in Figure 1 set out in paragraph 22 of Section 1 above, but without the need for excessive cost or relationship capital being expended. In effect, the “reset” that we are recommending creates an environment for transparently dealing with issues and encourages a pro-active approach to both identification and remediation of issues. At a very high level, a “reset” would typically involve (i) a systematic review of asset/services; (ii) a rectification plan; and (iii) a degree of relief from Deductions to allow programmed rectification to take place.

4. Our “reset” approach is intended to be used proactively. It is a renaissance approach and is not intended to be used as a means of rescuing a failing PFI project. If an SPV only seeks a “reset” after the relevant PFI project has hit significant identified problems, then there is much less incentive for the Public Authority to offer relief during periods that issues are being rectified.

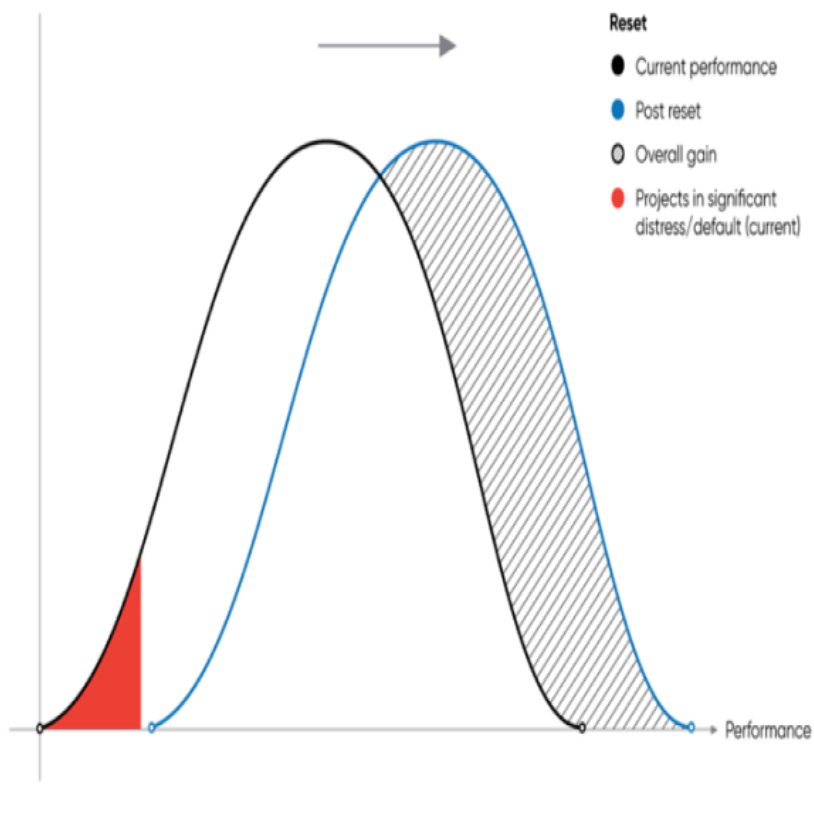
5. A “reset” is intended to deliver a significant shift in relative performance of the PFI Contract, moving the distribution curve to the right as set out below in Figure 2. There are some important points to note:

a. This is not about perfection, a normal distribution of performance will likely remain, but the overall level of performance will generally be higher as a result of undertaking a “reset”;

b. PFI projects that are in significant distress or default, which will happen (and continue to happen) for a variety of reasons, will need to continue to be worked through on a case by case basis.

c. A “reset” won’t remove the risk of a PFI project going into distress or default, but it will help reduce the frequency and likelihood of that happening.

Figure 2: The Opportunity Provided by a Reset



6. Based on the evidence that we collected during our review, we are satisfied that unless the “reset” approach is embraced by the public and private sectors, the pattern of behaviours that prompted this review is likely to continue and worsen. We would therefore encourage the IPA and SPV Owners to embrace the “reset” recommendation and lead the development of a template approach for a “reset”.

7. To help the development of a template approach, we set out below some key features that should form part of any “reset” approach.

Key features of any “reset” approach:

A. General Considerations

- The aim is to provide an opportunity for the SPV to review proactively the asset/service and implement an efficient rectification plan within a time limited period, during which relief from Deductions would be given.
- This should be adopted as a renaissance approach, rather than one of rescue, providing an opportunity for a collaborative approach to improve performance.
- Culturally, SPV Owners should feel incentivised to make the most of this one-off window of opportunity, and they should be encouraged to proactively seek to implement “resets”.
- On any PFI project, both the Public Authority and SPV Owners need to embrace the approach willingly – this is important to create the environment for greatest transparency and openness. There must be a commitment to collaborate.

B. Commercial Principles

- SPVs and their supply chain incentivised to identify and declare every issue they know about, in order to benefit from ‘amnesty’.
- Survey commissioned to identify issues - joint appointment & jointly agreed scope, paid for by the private sector.
- Consistency in “reset” approach, supported by frameworks/portfolio approach to make as efficient as possible.
- Survey to be used to prepare schedule of action.
- Any Health & Safety issues to be prioritised.
- Period of Relief provided - agreeing to suspend Deductions for a period of a timetabled action plan to allow SPV to purposefully schedule and addresses issues:

- This in effect gives an extension of the existing ‘excusing cause’ in many Payment Mechanisms for planned/programmed maintenance.
- Payment Mechanism would continue to operate as normal for day to day issues.
- Where a PFI project already has significant issues then, although many of the same principles could apply, a pre-agreed commercial settlement, in effect a “block deduction”, could be part of the commercial deal, rather than no Deductions.
- Timetable has to be meaningful and cannot be elongated in order to allow all supply chain claims to be worked through post survey. SPV Owners to agree approach with their supply chain in advance.
- Fast track dispute resolution for issues where views differ.
- Active management arrangements by SPV Owners going forward to be part of review.

C. Potential for Additional Items to be Addressed

We would propose that these additional items could be considered on a project specific basis:

- [Variations to incorporate elements of energy efficiency/decarbonisation.]
- [Variations to address issues where over specification of service has been identified.]
- [Speeding up variations.]
- [Agreeing handback process.]

D. Governance

- Consistent approach agreed centrally by IPA and Government Departments with SPV Owners.
- Local ownership - corporate leadership to agree to adopt approach, have a shared view of the end point, and work with Nolan principles in implementation and in operational approach thereafter.
- Ensure “Liaison Committees”, or equivalent, are operating effectively to monitor progress, to be regular minuted meetings, tracking actions and responsive to any escalation of issues.

- SPV Owners to consider benefits of inviting Public Authority officials to sit on the SPV's board of directors, or offer observer status at Board meetings

Glossary of Terms Used

Term	Definition
Debt Provider	An entity providing senior debt to a PFI project.
Deductions	Amounts periodically deducted from the Unitary Charge due to failure by the SPV to meet the performance requirements set out in the PFI Contract.
Government Department	Any relevant central government department that provides funding to the Public Authority with respect to the PFI Contract.
Management Services Provider	Any entity that provides, in respect of the PFI Contract, day to day contract management services to the SPV. Most of the Management Services Providers in the PFI market are owned by SPV Owners.
O&M Provider	Any entity that the SPV outsources its responsibility for the operation and/or maintenance of the PFI project to.
Payment Mechanism	The mechanism set out in the PFI Contract to calculate and levy Deductions.
PFI	Private Finance Initiative
PFI Contract	The document that established the contractual relationship between the relevant Public Authority and SPV, pursuant to which the SPV agreed to design build operate and maintain the relevant public infrastructure.
Public Authority	The public entity that procured the PFI project and entered into the PFI Contract.
SPV Owner	Any entity that owns shares in an SPV.

Term	Definition
SPV	The special purpose company established for the purposes of delivering the PFI project. This is the entity that the relevant Public Authority awarded the PFI Contract to.
Unitary Charge	The scheduled amount payable by the Public Authority to the SPV under the PFI Contract, for performance of the required services.

1. [Managing the expiry of PFI contracts 19 Mar 21 - Parliament \(publications\)](https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&ved=2ahUKEwihys6tu_v9AhWSN8AKHZf_Cp_oQFnoECCcQAQ&url=https%3A%2F%2Fcommittees.parliament.uk%2Fpublications%2F5144%2Fdocuments%2F50775%2Fdefault%2F&usg=AOvVaw2gF3yLH6EgVXPsqHO UduOh)
(https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&ved=2ahUKEwihys6tu_v9AhWSN8AKHZf_Cp_oQFnoECCcQAQ&url=https%3A%2F%2Fcommittees.parliament.uk%2Fpublications%2F5144%2Fdocuments%2F50775%2Fdefault%2F&usg=AOvVaw2gF3yLH6EgVXPsqHO UduOh)
 2. Standardisation of PFI Contracts Version 4, HM Treasury March 2007
 3. [Public Accounts Committee - Managing the expiry of PFI contracts](https://committees.parliament.uk/publications/5144/documents/50775/default/)
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 4. [NAO - Managing PFI assets and services as contracts end \(PDF, 700 KB\)](https://www.nao.org.uk/wp-content/uploads/2020/06/Managing-PFI-assets-and-services-as-contracts-end.pdf)
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