

## Insights

# PFI 'HEALTH CHECKS': THE LATEST PROPOSAL TO MANAGE PFI EXPIRY RISK

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## SUMMARY

On 16 December 2021, the PFI Centre of Excellence issued its Phase 1 PFI Expiry Health and Learnings Report. In this BCLP Insight, Jennifer Varley considers how these development areas may impact both the public and private sector.

On 16 December 2021, the PFI Centre of Excellence within the Infrastructure and Project Authority ("**IPA**") issued its Phase 1 PFI Expiry Health and Learnings Report.

The report confirms that following its 'health check' of 52 projects that are due to expire before the end of 2027, more than half of the projects need either critical, major or moderate additional work to be ready for handover and exit and only 5 projects were deemed to be 'at target readiness'. It then identifies key areas for further development.

In this Insight, we take a look at how these development areas may impact both the public and private sector.

## Background

The report follows a support plan issued by the IPA in August 2021, [Managing the Risks of PFI Contract Expiry](#) which I blogged about [here](#), in which the IPA proposed to undertake a health check of PFI projects to assess their readiness for expiry.

## What does an expiry health check (or 'EHC') involve?

This is a review by the IPA of key project documentation and a structured interview with the contracting authority ("**CA**"), using a structured questionnaire. The review then uses a diagnostic tool to help assess and benchmark the project's readiness to see the project through its final years of operation and expiry phase and assigns a rating to each project.

The 52 projects in the report represent 9% of the 551 projects in the portfolio and nearly 70% of the projects expiring before the end of 2027. As the report points out, it's likely that many of the 52 projects assessed will not have benefitted from the Standardisation of PFI Contracts so there are likely to be greater risks inherent in these contracts when compared to later contracts benefitting from standardised terms.

## **Results of the 52 PFI 'Health Checks'**

The 52 projects were given an individual 'traffic light' rating of Red, Red/Amber, Amber, Green/Amber or Green.

25% were given a Red or Red/Amber rating meaning that these projects need either 'critical additional work' or 'major additional work' to achieve readiness for expiry. A further 29% of the projects need 'moderate additional work' to achieve target readiness.

Out of the 52 projects, 46% received a Green or Green/Amber rating meaning that they are at 'target readiness' or limited additional work is required to achieve the target. A total of 5 of the 52 projects were deemed to be 'at target readiness.'

The report also highlights that there is a tendency for projects expiring between 2022 and 2024 to have a Red to Amber rating. For example, 19 of the 21 projects expiring before the end of 2024 were assessed as Amber to Red, indicating "*that there is an immediate need for action on these projects to minimise the loss of value and disruption to public services.*"

## **Themes from the 52 Health Checks**

The report draws emerging themes from the data and interviews undertaken with the relevant contracting authorities across the 52 projects. The themes are grouped under six specific headings (Expiry Programme Management, Resourcing and Capability, Relationships, Commercial Position, Future Services and Asset Condition).

The report also identifies two general themes, reflecting the lack of standardisation in early PFI contract which increased the risks of gaps and uncertainty:

- Lack of access to core information including contract documentation and asset registers and information needed to manage the process effectively; and
- Lack of understanding of the contractual terms and conditions.

## **Other findings**

The other findings made and set out below highlight the challenges facing the CAs when managing these risks, such as lack of resources, as well as the need to take immediate steps.

- **Expiry Programme Management:** The majority of contracting authorities surveyed need to improve their management of the expiry process, to varying extents, and c.80% of projects don't have a robust and approved plans for exit. There are various recommendations for improving these plans.
- **Resourcing and Capability:** c.65% of projects reported that they did not have a sufficient team to manage expiry and there is a lack of skill and expertise for the expiry process. The IPA will be considering how to increase expertise within the public sector, including "*developing a cadre of PFI experts who can be deployed to support departments and CAs who will be able to embed key lessons in project expiry plans*". This may be one way for the IPA to support teams that feel that they are currently under-resourced or do not have a full suite of necessary expertise.
- **Relationships:** Of the 52 projects reviewed, 75-90% said that relationships were generally good and collaborative. However, the IPA also concludes that c.75% of CAs are not having sufficient discussions with the private sector around expiry and there are indicators that relationships are likely to weaken as the projects approach expiry.
- **Asset Condition:** Of the 52 projects, around 80% of the contracts had asset condition requirements at expiry but around 70% of CAs believe that these provisions are not clear. These are potential areas of dispute upon handover and expiry. The report notes that the majority of CAs believe that there is sufficient time between survey and expiry for asset rectification works to be completed. However, the IPA's position is that these views may be overly optimistic and CAs should gather more information to support asset condition.
- **Commercial Position:** Contract drafting lacks clarity in c.70% of contracts, due to lack of a standardised form. The report concludes that the CAs are often optimistic around private sector engagement but don't fully appreciate "*the changing private sector drivers at expiry*."
- **Future Services:** The report notes that CAs must ensure that future services plans are developed early and integrated with the expiry process.

## Lessons learnt and next steps

The report provides some 10 key learnings for contracting authorities by extrapolating from the first 52 checks completed by the IPA. CAs are encouraged to incorporate these learnings into their plans. However, authority and project specific advice is also available as the IPA offers all PFI projects within 7 years of expiry an initial expiry health check with further reviews at 5 and 3 years.

## What does this mean for the public and private sector?

Reports from the CAs are positive in that their relationships with the private sector are generally good and collaborative. However, there is a perception amongst some CAs, and the IPA, that this

relationship could decline as the projects approach expiry.

Therefore the challenge for both public and private sector is to find ways to further foster and maintain the existing collaboration throughout the handover and expiry process. Neither the CAs nor their private sector counterparties stand to benefit from costly and protracted disputes on handover and expiry. This could involve proactively putting in place mechanisms for dealing with any potential disputes collaboratively.

Collaborative dispute resolution can involve:

- working through a contractual tiered dispute escalation procedure (if there is one);
- creating a bespoke collaborative method of dispute resolution appropriate to both parties and the nature of the dispute(s); or
- seeking to agree a similar process with the help of an independent third party, often a mediator who can structure a mediation process to suit the more complex nature of PFI disputes.

By dealing with disputes efficiently as they arise and by using a pre-determined and agreed mechanism for resolution, both sides can potentially avoid the downward spiral in relations that is often inevitable as differences and difficulties arise. This is why early engagement about the handover and expiry process between public and private sector is critical and will help to clarify each parties' expectations, allowing time for a more structured hand over and exit process to be agreed.

The lessons in the report are also important to the private sector, particularly those around understanding the contract terms, gathering data around the asset's condition, understanding the operation of future services and ensuring that it has the right team dedicated to handover and expiry.

To have successful discussions (and potentially negotiations) around handover and exit, both sides need to be adequately prepared for those conversations and have the relevant and up to date information at their disposal and they must both understand the pressures and motivations on the other side of the table. Only then can the parties begin to have productive discussions around handover and exit. Not planning ahead to manage these issues is likely to result in the same issues coming up later when there is less of an opportunity to resolve them collaboratively and efficiently.

## **RELATED PRACTICE AREAS**

- Commercial Construction & Engineering
- Construction Disputes

## MEET THE TEAM



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