

Katherine Apps KC and David Sawtell¹

30 May 2024



Contents

About PFI	2
The contractual structure for PFI handback	4
Estate management	4
PFI handback and Net Zero	5

For over 20 years, PFI was used in the UK to procure, finance and operate numerous public infrastructure projects. Many of the original contracts are nearing their 25-30 year expiry date, raising important practical and legal consequences for what comes next. This is increasingly the subject of public discussion and debate following the UK Infrastructure and Projects Authority commissioned White Fraiser Report published in July 2023.

In this article we discuss the origins of PFI in the UK and some of its central characteristics, before considering some of the diverse public and private law legal issues which are likely to arise, both from the contract directly, but also in relation to assets (both land and staff), public funding and the public nature of some of the relevant decision making.

Procurement law limitations and subsidy control	6
Staffing of the facilities management contracts	6
Judicial review risks	7
Decision making – whose choice is it? ..	8
Conclusion	8

This article covers:

1. The history of PFI in the UK.
2. The contractual structure for PFI handback.
3. Disputes over the implications of long-term estate management.
4. The impact of decarbonisation and Net Zero policies.
5. The limitations imposed by procurement law and subsidy control.
6. Potential issues arising from staffing of the facilities management contracts.
7. Judicial Review risks.
8. Decision making – whose choice is it at handback?

¹ The authors are both barristers at 39 Essex Chambers in London. Their views in this paper are their own personal views and should not be attributed to chambers as a whole or to any of the clients they act for. This paper should not be read as including any legal advice. The authors wish to thank Kate Grange KC and Adam Robb KC for their helpful comments on previous drafts and discussions. All errors are, however, entirely their own.

About PFI

Private Finance Initiative ("PFI"), both in its original form and in what later became known as PF2, led to £56 billion of private sector capital investment in over 700 UK public infrastructure projects.² Within the UK it was launched in 1992 by Conservative Prime Minister John Major's government, although its use in practice expanded considerably after 1996 into the 'New Labour' years under Tony Blair and Gordon Brown.³ It originally grew from a desire to 'privatise' public service and infrastructure delivery in 'partnership' with, and ultimately funded by, the public sector.⁴ The funding, however, was not direct. The significant driver for the model from 1992 within the UK and Europe was the EU Treaty of Maastricht and preparatory stages for developing a European Monetary Union (EMU), which later became the Eurozone. In 1992, this was controversial within the UK; it was not clear whether the UK would ultimately be inside or outside the EMU. The UK negotiated various opt outs to the Treaty of Maastricht, including an opt out from the EMU. However, to keep options open, one of the conditions for qualification related to various technical 'convergence' criteria, which included accounting for public spending from central Treasury resources. As set out below, one of the core features of PFI was to alter how public expenditure was accounted for centrally, by spreading the cost diffusely and throughout the period of the contract while incorporating private sector financing and funding models.

The use of PFI in new projects ended with the 2018

Budget, when the then Conservative Chancellor, Philip Hammond, announced that PFI would no longer be used for new government projects.⁵ This might not be the end of the model completely, however as there is mounting speculation that Labour may reintroduce a form of PFI if successful at the next UK General Election, while a form of private financing known as direct procurement for customers ('DPC') has been promoted by Ofwat, the Water Services Regulatory Authority, for water companies to deliver major infrastructure projects.⁶

PFI contracts in the UK were often let with a term of 25 to 30 years or so. Consequently, a wave of PFI expiries is due to take place over the next few years, with around 371 estimated as due to expire between 2025 and 2035.⁷

At the heart of any PFI contract is the concept that a private sector entity (a special purpose vehicle, usually referred to as Project Co) should take responsibility for the funding, design and construction of the original facility and then its operation for a term of years, frequently for decades, thus transferring the major risks to the private sector.⁸ Project Co provides the funding from investors and subcontracts the design and construction to a construction company and the operation of the facility to a facilities management company. Project Co (and its investors) earn the return through a stream of unitary payments across the term of the contract from the public authority.⁹ At the end of the contract term, the

2 PFI Centre of Excellence website: <https://www.gov.uk/government/collections/public-private-partnerships#:~:text=PFI%20have%20delivered%20around%20military%20equipment%20and%20accommodation>.

3 Michael Spackman, 'Public-private partnerships: lessons from the British approach' (2002) 26(3) *Economic Systems* 283.

4 This was not a new aim, when considered worldwide. The history of public-private partnership internationally can be traced into at least the late eighteenth century: Piet de Vries, 'The modern public-private demarcation: History and trends in PPP' in Piet de Vries and Etienne B. Yehoue (eds), *The Routledge Companion to Public-Private Partnerships* (Routledge, 2013). In the USA several public private infrastructure financing projects had been built, for example the Dulles Greenway road project (1988) https://www.fhwa.dot.gov/ipd/project_profiles/va_dulles_greenway.aspx

5 HM Treasury, 'Budget 2018 Private Finance Initiative (PFI) and Private Finance 2 (PF2)' (29 October 2018) <https://www.gov.uk/government/publications/private-finance-initiative-pfi-and-private-finance-2-pf2-budget-2018-brief>

6 'UK water companies embrace PFI to deliver £14bn of infrastructure' *Financial Times* (London, 17 May 2024) <https://www.ft.com/content/980821ed-d6a6-4898-8ac9-4cba4ec67623>

7 Kerry Lorimer, 'PFI Hand-back: the challenges and opportunities' *Facilitate* (15 January 2024).

8 Robert J. Kirk and Anthony P. Wall, 'Substance, Form and PFI Contracts' (2001) 21 *Public Money and Management* 41.

9 Emil Evenhuis and Roger Vickerman, 'Transport pricing and public-private partnerships in theory: Issues and suggestions' (2010) 30 *Research in Transportation Economics* 6.

facility is handed back to the authority, which also resumes responsibility for service delivery. The transfer of risks such as construction defects, repair and facility management, and the operational cost of the facility, is therefore deferred rather than permanent. PFI contract expiry, therefore, sees a public authority take on full responsibility for a facility and the services, even if it then decides to re-let service delivery under a new contract or divides or “fragments” the contracts for separate service delivery.

In the UK, the relevant central government bodies have been alive to the difficulties that PFI expiry and handback might cause. When the Infrastructure and Projects Authority ('IPA') set up the PFI Centre of Excellence in 2020,¹⁰ contract expiry was identified as one of the four projects that the PFI Contract Management Programme would take on. In August 2021, the IPA published a policy paper, 'Managing the Risks of PFI Contract Expiry: IPA support plan for contracting authorities', written by the PFI Centre of Excellence,¹¹ while the IPA began offering support such as 'expiry health checks'. This report recommended that all authorities should start planning for expiry at least seven years ahead of the end date. In February 2022, the IPA produced a further document, 'Preparing for PFI contract expiry'.¹² This set out more detailed guidance on PFI expiry, drawing on the experience of three authorities with experience of undertaking PFI expiry programmes, namely National Highways, MoJ PFI Prisons, and HMRC STEPS. In September 2022 law firm DLA Piper published 'Project Autumn'¹³ following a year-long consultation into the expiry and handback process which made a

number of recommendations including that there be a conduct charter, an expiry and handback forum and a specialist dispute resolution council or arbitral panel consisting of 5 leading adjudicators and arbitrators with sufficient expertise to rapidly and accurately determine legal disputes. In July 2023, the IPA published the White Fraiser Report into the status of behaviours, relationships and disputes across the PFI sector which considered Project Autumn along with other representations from public sector and private sector stakeholders.¹⁴

There are considerable risks involved in the expiry of PFI contracts. The National Audit Office ('NAO') has, for a number of years, warned that public sector bodies risk underestimating the time, resources and complexity involved. For example, in a report published in May 2020, they identified the possibility of operational disruption, lack of service continuity, and increased costs.¹⁵ The potential for disputes has also been well publicised. The White Fraiser Report, warned that, without intervention, they expected "*the current trend towards increased disputes and deteriorating relationships to accelerate.*"¹⁶ The DLA Piper 'Project Autumn' report, published in September 2022, warned of a "*slue of disputes*".¹⁷

What has been less obviously broadcast and analysed is the form that these disputes are likely to take, arising out of both private and public law. This short paper will consider what the likely origins of those disputes will be, and what form they might take.

10 The IPA is a non-governmental public body reporting both to HM Treasury (responsible for authorising and ultimately meeting expenditure from state resources) and the Cabinet Office (the department responsible for government contracting and procurement) <https://www.gov.uk/government/organisations/infrastructure-and-projects-authority/about>

11 'Managing the Risks of PFI Contract Expiry' (16 August 2021) <https://www.gov.uk/government/publications/managing-the-risks-of-pfi-contract-expiry>

12 IPA, 'Preparing for PFI contract expiry' (28 February 2022) <https://www.gov.uk/government/publications/Preparing-for-pfi-contract-expiry>

13 www.dlapiper.com/-/media/files/news/2022/09/project-autumn-report.pdf?rev=-1

14 <https://www.gov.uk/government/publications/white-fraiser-report-private-finance-initiative-sector/white-fraiser-report>

15 National Audit Office, *Managing PFI assets and services as contracts end* (HC 369, May 2020) 7.

16 <https://www.gov.uk/government/publications/white-fraiser-report-private-finance-initiative-sector/white-fraiser-report>

17 <https://www.dlapiper.com/en-gb/news/2022/09/dla-piper-findings-from-public-private-partnership-consultation>

This paper will discuss the following.

1. The contractual structure for PFI handback.
2. Disputes over the implications of long-term estate management.
3. The impact of decarbonisation and Net Zero policies.
4. The limitations imposed by procurement law and subsidy control.
5. Potential issues arising from staffing of the facilities management contracts.
6. Judicial Review risks.
7. Decision making – whose choice is it at handback?

The contractual structure for PFI handback

The PFI contracts that will expire in the next few years may well be some of the earlier contracts, which pre-date the introduction of Standardisation of PFI Contracts Version 1 in 1999. It is therefore difficult to generalise how PFI contracts deal with the question of handback. At a high level of abstraction, however, all PFI contracts introduce an element of distance between the public authority and service delivery by transferring construction and operational risk to the private sector. On the expiry of a PFI contract, therefore, the information that the authority has about service delivery and the physical estate involved may well be limited, with ambiguous (or perhaps even no) express terms dealing with information transfer. This information deficit was identified in the NAO report: 55% of public authority respondents to its survey recognised the need for more knowledge about the condition of PFI assets.¹⁸

A 'typical' PFI handback contract procedure often seeks to define the condition of the facilities which will be handed back. This may well be by reference to due performance by the PFI Project Co of the Service Level Specification and the Method Statement for the Facilities Service, as

well as consistency with the applicable design life requirements in the Construction Requirements. This, of course, may well require professional judgement to be exercised against potentially unclear standards. The Project Co may be required to produce a proposal as to maintenance works (which may be defined as the 'Handback Works') that it must carry out before the expiry date of the term to satisfy the contractual standard for the condition of the facility on handback. If the parties cannot reach agreement as to the content of those works (or their cost), the dispute resolution procedure of the PFI contract may well be engaged. It may fall to the public authority to decide whether or not to certify that the Handback Works were carried out to its satisfaction; if not, there is likely to be another potential dispute between the parties.

There is undoubtedly concern as to the clarity of PFI contracts on expiry. In the NAO report, only one-third of respondents stated that their contracts were clear about the roles and obligations of different parties at expiry.¹⁹ This ambiguity, coupled with potential under-resourcing of facility management, together with public authority concerns about the condition of the physical assets being returned, provides fertile ground for disputes.

Estate management

One of the greatest concerns for public authorities is that the Project Co will hand back substandard facilities, leaving them with the cost of repairing and renovating them and, potentially if they include hazardous materials or contaminated land, the cost of removing those and the automatic liabilities which come with the land.

The February 2022 IPA guidance, 'Preparing for PFI contract expiry' identified that there can be substantial financial impacts if assets are not handed back in line with contractual standards.²⁰ All PFI contracts should have some mechanism for maintenance and repair of facilities and

¹⁸ NAO, Managing PFI assets, 4.

¹⁹ NAO, Managing PFI assets, 9.

²⁰ IPA, 'Preparing for PFI contract expiry' 5.

buildings during the contract term. There are dangers, however, if these were not monitored or policed effectively during the contract term or if problems known to some locally were not been passed up the chain to those with decision making powers and responsibility. At the same time, the authority may be taking back an estate that was originally constructed twenty to thirty years ago, sometimes with construction defects, and potentially in need of substantial refurbishment, modernisation or renewal. The IPA February 2022 guidance recognises that the Project Co should have asset data (including as-built information and maintenance records),²¹ although this may be partial or limited in practice. As set out above, any dispute about the condition of the physical facilities is likely to result in the formal express contractual dispute resolution procedure being invoked, which may well be through adjudication or arbitration rather than by court resolution.

Parallels can be drawn with the return of commercial premises at the end of a business lease, where the question of terminal dilapidations becomes a source of contention between landlord and tenant. In both scenarios, the party handing back the facility or premises had a legal obligation to ensure that it was kept in repair and maintained to a particular contractual standard. Some PFI project sites, in fact, were leased out to the operator. One significant difference between the two scenarios is that a substantial body of case law and practice has grown up around commercial property dilapidations, with statutory intervention into the parties' rights in section 18 of the Landlord and Tenant Act 1927 creating a statutory cap on the landlord's rights to damages. The terms commonly used in PFI handback provisions have not been so regularly tested, and the arguments as to how the landlord's entitlement to damages should be quantified which raged in respect of commercial leases prior

to the 1927 Act, do not reflect the modern law of damages.²²

One early indication of the kind of dispute that might arise can be seen in *Solutions 4 North Tyneside Ltd v Galliford Try Building 2014 Ltd [2022] EWHC 2372 (TCC)*, 204 ConLR 101. The PFI project involved the construction of new-build dwellings, as well as the refurbishment of other facilities. The Project Agreement contained an Output Specification that set out the minimum design lives to be achieved, including a residual life expectancy which was to remain when the dwellings were handed back to the Council in 2042. The key issue in the case was whether the defendant Contractor had to return the refurbished dwellings with a design life of the same duration as the new building dwellings. Eyre J agreed with the Contractor that it was not required to carry out such enhanced works, and that the life expectancy requirements only applied to the new-build properties. It is noteworthy that the judgment alludes at [12] to the length of the dispute, which had already been referred to adjudication. A 'standard of repair' style dispute is familiar to commercial property practitioners; disputes involving PFI contracts raise fresh issues of the standard of construction originally intended as well as ongoing repair and maintenance obligations.

PFI handback and Net Zero

One of the complications, but also the opportunities, created by PFI handback is the role that it might play in decarbonisation and Net Zero policies. As the February 2022 IPA guidance, 'Preparing for PFI contract expiry' notes, over the course of the PFI contract term the underlying technology, structures and standards will have likely changed.²³ PFI contract expiry and handback, coupled with the goal of reducing greenhouse gas emissions by at least 100% of 1990 levels (net zero) by 2050 created by the Climate Change Act

21 Ibid 37.

22 The leading case remains *Joyner v Weeks* [1891] 2 QB 31; see, for example, *Sunlife Europe Properties v Tiger Aspect Holdings* [2013] EWCA Civ 1656. *Joyner v Weeks* was decided before the construction case of *Ruxley Electronics & Construction Ltd v Forsyth* [1996] AC 244. As noted in the latest edition of Nicolas Dowding KC, Kirk Reynolds KC and Alison Oakes, *Dilapidations: The Modern Law and Practice* (Sweet & Maxwell 2023) in Ch 29, it is arguable that a court may well approach an end-of-lease case where section 18 of the 1927 Act is not engaged in a different way to *Joyner v Weeks*.

23 IPA, 'Preparing for PFI contract expiry' 5.

2008, means that an authority will almost certainly have to shape its PFI handback policy (including its policy for providing services and managing its estate) with this in mind and have due regard where necessary.

Procurement law limitations and subsidy control

Procurement law and the law of subsidy control (previously state aid) have their roots in EU law. They were both complex areas of law. At the risk of oversimplification, they provide for:

- a) a legislative framework making it unlawful for public authorities to expend state resources on public projects which exceed their financial worth, so as to avoid over compensating private actors and distorting competition,²⁴ and
- b) regulating the process for awarding, extending and re awarding public contracts over a particular (potentially economically distortive) monetary limit with undertakings to ensure that such processes are transparent, ensure equal treatment and are not distortive of competition.

Post-Brexit, UK law has, to some extent, departed from EU law on state aid and public procurement, and there is a new domestic legislative framework (with the Subsidy Control Act 2022 taking over from previous State aid law (with direct effect under the European Communities Act 1972, Procurement Act 2023 and the Procurement Regulations 2024) expected to go live from October 2024 taking over from the Public Contracts Regulations 2015). Some of the provisions are the same and some differ from the previous legal position while the UK was a member state of the EU.

This is not the end of the story on public procurement and subsidy control because there are also some relevant provisions in the Trade and Cooperation Agreement between the UK and EU, which is domestically incorporated and which is justiciable

in UK Courts (see e.g. *Heathrow Airport Ltd V HM Treasury* [2021] EWCA Civ 783).

What this emerging body of law does is potentially limit the options available to public authorities who are undergoing handback of existing PFI contracts. Re-tendering of facilities management services will often fall above the relevant economic thresholds to engage the modern public procurement regime. This is not a process which can be undergone (lawfully) instantaneously.

Furthermore, there are legislative limitations on whether existing contracts can be extended or where "direct awards" (i.e. extensions to contracts, or new contracts without engaging in a competitive procurement process). If the true complexity of the issues arising at handback become apparent late in the day when a full competitive procurement cannot be completed before the handback date, the choices can become stark, expensive and subject to potentially substantial risks of legal challenge from both incumbents and potential providers.

Staffing of the facilities management contracts

Facilities management contracts, which are limited to such services, are often considered to be mainly characterised by the provision of services through labour, whereas contracts which require other assets (e.g. plant, buildings etc) may be characterised by those assets. This, and the ultimate intended structure of future service provision, can lead to complex issues in employment law arising under the Transfer of Undertakings (Protection of Employment) Regulations 2006 ('TUPE'), which provide for automatic movement and transfer of the workforce when there is a service provision change or a transfer of "assets." This can become especially complex if there is 'fragmentation' of the original contract and different destinations for the obligations owed under the original contract. As early as 2008, the NAO issued guidance on

²⁴ For one of the oldest cases concerning funding for Port infrastructure under EU state aid law see the European Commission's decision in relation to the Italian Port of Ancona (18 July 2001).

“protecting staff in PPP/ PFI deals.”²⁵ However, since then the case law under TUPE has moved on significantly. This is an area which cannot be contracted out of or directed purely to arbitration. The automatic transfer of employees at the moment of transfer arises by operation of law, and can only be altered by the employee (and not the employer) objecting to the transfer. Protective awards for failing to comply with information and consultation requirements can be substantial across a large workforce and can be indemnified, but falls within the statutory jurisdiction of the Employment Tribunal, which cannot itself be contracted out of (save by the agreement of the employee individually with specific procedural safeguards).

Judicial review risks

Some may wonder why judicial review is relevant at all, as PFI agreements are commercial contracts, and therefore the interpretation of their terms lies within the realm of private law. Where disputes ‘really’ live in the world of private law, the Administrative Court either has no jurisdiction, or declines jurisdiction due to the existence of a suitable alternative forum elsewhere (*Hampshire CC v Supportways Community Services ('Supportways')* [2006] EWCA Civ 1035 per Neuberger LJ at [38]; see also [45]); see also Mummery LJ at [56]-[60]). One of the consequences of being in the civil/commercial courts rather than the Administrative Court is that injunctive relief is not available against ‘the Crown’ (Crown Proceedings Act 1947 s 21: See *Quest Education Services Ltd v Department for Education* [2022] EWHC 3578 (KB) per Freedman J).

It would be wrong, however, to think that judicial review has no role to play in the kind of disputes that will arise during handback. Some decisions which are not purely “contractual” decisions,

do inhabit the world of public law. Others are regulated by specific legislation (e.g. procurement and Subsidy control). Issues of forum can become strategically extremely important for parties in potentially huge value commercial/quasi-public disputes. It is not uncommon for there to be some jostling between the different courts and other bodies as to which forum is appropriate (see for example the comments of Laing LJ in *R(on the application of RRR) v British Standards Institution* [2024] EWCA Civ 530 at [17] in the context of an interim relief application.²⁶

It should not, therefore, be assumed that PFI disputes will necessarily be litigated in traditionally private law fora or can be exclusively directed to an expert arbitral panel. It is likely that there will be further applications for judicial review in these cases, as demonstrated by, for example, Birmingham City Council’s judicial review application concerning the lawfulness of central government’s decision to withdraw funding for their Highways Maintenance and Management Services PFI – in which judgment is awaited.²⁷ While this is a particularly PFI-focused judicial review, and both parties are public authorities, there is ample scope for potential public law challenge in relation to some of the other decisions and decision-making processes which can arise in the PFI handback context, for example in relation to whether there has been adequate consultation, procedural fairness under good faith duties and compliance with the *Tameside* duty to consider what information needs to be obtained prior to the making of a decision. It is also likely that challenges could arise over harder edged specific legislative provisions or Article 1 Protocol 1 of the European Convention on Human Rights which protects against deprivation of property and possessions (including contractual rights).

²⁵ chrome-extension://efaidnbmnnibpcajpcgclefindmkaj/https://www.nao.org.uk/wp-content/uploads/2008/03/0708_protecting_staff.pdf

²⁶ Laing LJ stated that it would not be lawful for a public decision maker to delegate its functions to an arbitrator in a contract. However, such provisions routinely appear in PFI and PF2 contracts. The Court of Appeal was considering this case in the context of an interim relief application, in allowing the appeal. The substantive judicial review claim has been listed for a full hearing where this issue may well be considered further.

²⁷ https://www.birmingham.gov.uk/info/20013/roads_travel_and_parking/2882/statement REGARDING birmingham_highways_maintenance_and_management_services_pfi/5 *R(Birmingham City Council) v HM Treasury*.

Decision making – whose choice is it?

The handback of PFI contracts gives rise to a number of decision points both under the contract and when navigating decision-making at various points during the handback process including when deciding about continuation of service provision and assets going forwards for the public authority, and the incumbent provider.

It should not necessarily be assumed that the decision maker, or even the public authority, will always be the same. The inherent nature of PFI contracts means that those making decisions about the need for particular services, or how dilapidations are to be dealt with, may not be the same person and may not even work in the same organisation (see for example the Birmingham City Council judicial review claim). The value of some PFI contracts is so large that decisions may have consequences for the solvency of the public body itself, its audit, accounting and internal governance processes and, in some cases, its dealings with HM Treasury or Cabinet Office. These are the sorts of practical issues that can either delay relevant decision making or lead to complexity in disputes down the line. They can also lead to disputes which will ultimately reach Court or arbitration, or involve a potential jostle between those fora.

As the White Fraiser report noted, many decisions may be made in the context of an information deficit or asymmetry. Multiple legal issues may arise as between different potential public sector decision makers when those information imbalances potentially obscure what the decision options are and what the costs and risks will be for those taking them.

For further queries please contact: Sheraton Doyle or Harvey Scott
sheraton.doyle@39essex.com • harvey.scott@39essex.com
Chief Executive Officer: Lindsay Scott

39essex.com
020 7832 1111

Conclusion

PFI contract expiry and handback represents a significant challenge for a range of different public authorities, Project Cos, funders and their professional advisors. Public sector bodies (including those which are central, devolved, local and sectoral), will, in some form, be taking over facilities (including inheriting any construction defects in them). They will be anxious to ensure that they have been maintained appropriately and kept in good repair. At the same time, the authority will face considerable immediate challenges, not least in ensuring the continuity of service delivery, while keeping in mind the requirements of decarbonisation and Net Zero policies, and while juggling pressures on public finances, the quantification of liabilities and uncertain law. Many PFI contracts will contain inadequate or ambiguous express terms dealing with handover. This creates a significant challenge for dispute resolution that those involved with PFI contracts will need to prepare for in sufficient time before the handback date, and be prepared to navigate the knotty world of disputes to resolve them.



Katherine Apps KC

Call 2006 | Silk 2023



David Sawtell

Call 2005

39 Essex Chambers is an equal opportunities employer.

39 Essex Chambers LLP is a governance and holding entity and a limited liability partnership registered in England and Wales (registered number OC360005) with its registered office at 81 Chancery Lane, London WC2A 1DD.

39 Essex Chambers' members provide legal and advocacy services as independent, self-employed barristers and no entity connected with 39 Essex Chambers provides any legal services. 39 Essex Chambers (Services) Limited manages the administrative, operational and support functions of Chambers and is a company incorporated in England and Wales (company number 7385894) with its registered office at 81 Chancery Lane, London WC2A 1DD.