

**Social Care Procurement Pack Guidance**

**PFI Project Agreement**

## Contractual Issues Covered In Standardisation of PFI Contracts

- 1 A model contract for a social care PFI project is included in this Procurement Pack (the "Model Contract") and Local Authorities must use this Model Contract as a basis for their projects in order to secure PFI credits. The Model Contract is based on the standard National Health Service PFI Contract (SF3) and incorporates and builds upon the approaches set out in the HM Treasury Standardisation of PFI Contracts Version 4 dated March 2007 ("SoPC"). Usage of this Model Contract should reduce the time and cost of negotiations for both the Local Authority and the private sector partner. The Model Contract is intended to enable Local Authorities to strike a balance between a contractual position which is commercially deliverable for the private sector and which can provide value for money for the Local Authority.
- 2 The Model Contract will form part of the ISDS documentation. Using the Model Contract enables the focus of project negotiations to be on project specific issues rather than on issues that are generic to all projects, e.g. treatment of change in law, compensation on termination and refinancing.
- 3 This Section of the Procurement Pack examines the relevance to Local Authority social care PFI projects of contractual issues covered in SoPC. Unless otherwise indicated, the 'Sections' referred to in this Guidance relate to the relevant Sections of SoPC and not this Procurement Pack.

### Introduction – Section 1

- 4 Section 1 of SoPC includes required drafting for a range of general definitions. The required drafting in SoPC has been incorporated into the Model Contract.

### Duration of Contract – Section 2

- 5 Section 2 of SoPC sets out the factors to be considered in determining the duration of the contract. These issues are relevant to Local Authority social care PFI projects. Local Authorities have typically used a contract period of 25 years for the standard bid. The model instructions and guidance to bidders included in this Procurement Pack assume that Local Authorities will be prepared to accept different contract periods as part of a variant bid proposal if this can be shown to improve affordability and value for money.

### Service Commencement – Section 3

- 6 Sections 3.1, 3.2, 3.3 and 3.5 of SoPC relating to commencement of the Services are all relevant to Local Authority social care PFI projects.

### Submissions of Designs and Information to the Local Authority – Section 3.4

- 7 SoPC suggests that key aspects of the Service Provider's bid should be incorporated into the contract to ensure that the Service Provider is contractually bound to deliver the Services in accordance with the proposals submitted as part of the bid. The model documentation included in this Procurement Pack assumes that a number of technical and service delivery proposals will be sought as part of the bids and used as part of the contract in the manner suggested in Section 3.4.

### Acceptance and Service Commencement – Section 3.6

- 8 SoPC relates to acceptance and service commencement. Section 3.6.2 identifies the details that should be set out in the contract in relation to the commissioning and certification of new facilities which have been incorporated into the Model Contract. SoPC also specifies that the contract should set out who is responsible for assessing satisfaction of the tests. The choice of arrangements is a matter for local discretion but the majority of Local Authorities have adopted the 'independent certifier' approach which is reflected in the Model Contract.

### Existing/Interim Services – Section 3.7

- 9 SoPC refers to the issues that arise if a Service Provider is taking over existing services, as well as contracting to provide new or additional services. Although some Local Authority social care PFI projects will involve the provision of existing services for an initial or interim period until any new and/or refurbished facilities become operational. The Model Contract assumes construction of a new Facility with Services commencing on completion of the Works and does not include provision for interim services.
- 10 Where interim services are required, the Services Specification and payment mechanism will need to include arrangements for ensuring that the Service Provider is only paid for those elements of the Services that are delivered in accordance with an achievable Services Specification (which may have a lower performance standards than the "full" services). The Service Payment during the interim phase should only reflect that the interim Services are meeting existing standards and should not include any payment towards a Service Provider's debt costs.
- 11 Local Authorities will need to carefully consider how to deal with poor performance during any interim phase. Service Providers and funders are generally resistant to any possibility of termination due to poor performance of the interim services. If performance is sufficiently poor, Local Authorities should consider whether the relevant sub-contractor should be replaced.
- 12 Where provision of interim services is required, the Local Authority should identify in the instructions and guidance to bidders the structure that it believes will offer Best Value within the parameters of project affordability, bankability and a reasonable and realistic approach to risk allocation. Local Authorities will also wish to invite bidders to offer alternative approaches if improved value for money can be shown.

### Range of Services to be provided - Section 3.8

- 13 A new section has been included which gives guidance of the appropriateness of including soft services in the Project.

### Early Works Agreement - Section 3.10

- 14 A new section has been included which sets out guidance on early works agreements. Such agreements should not be entered into unless absolutely necessary.

### Protections against late service commencement – Section 4

- 15 Section 4 of SoPC is relevant to Local Authority social care PFI projects. A new facility will take a period of months and/or years to construct and a Local Authority will want to ensure it is protected against prolonged delay by the Service Provider in achieving completion of the

Works and commencing provision of the Services. There are a number of mechanisms through which such protection can be obtained.

- 16** SoPC discusses the imposition of liquidated damages but points out that it will result in an increased Service Payment. Liquidated damages are therefore not value for money unless the costs incurred by the Local Authority as a result of any delay is substantial. Provisions for liquidated damages are not included in the Model Contract.
- 17** Section 4.5 of SoPC provides guidance on the use of longstop dates. Local Authorities procuring social care PFI projects have typically incorporated a longstop date after which the contract may be terminated if the Service Provider has not completed the required works. The longstop date should be applied to the whole of the social care service, rather than to any individual investment phase. The Model Contract incorporates a longstop date.

### **Bonus Payments for Early Service Commencement – Section 4.6**

- 18** SoPC includes guidance on dealing with early service commencement. This is unlikely to be an issue for Local Authority social care PFI projects. No such provisions are included in the Model Contract.

### **Supervening Events – Section 5**

- 19** Section 5 of SoPC is relevant to Local Authority social care PFI projects. Three categories of causes of delay in service commencement are identified, for which relief may be appropriate:
- 19.1 Compensation Events – events which are the Local Authority’s risk and for which the Service Provider should be compensated;
  - 19.2 Relief Events – events that are best managed by the Service Provider and for which the Service Provider bears the financial risk but in respect of which no rights of termination should arise; and
  - 19.3 Force Majeure Events – a limited set of events that are best shared and in respect of which rights of termination can arise.
- 20** The guidance on each of these events in Section 5 is relevant to Local Authority social care PFI projects and SoPC includes required drafting for supervening events, which has been incorporated into the Model Contract.
- 21** Compensation Events (which are limited to breach of contract by the Local Authority) only apply during the construction phase. Bidders often seek to extend Compensation Events to the Service Period. This extension is contrary to the guidance set out in Section 5.2 of SoPC and should be resisted. Compensation Events during the Service Period can be considered by Local Authorities but must be identified and justified on project specific grounds in accordance with Section 5.2.1.5 of SoPC. An alternative approach for Local Authorities to consider is for the Service Provider to be offered protection through a Relief Event and/or an Excusing Cause under the payment mechanism.

### **Information Warranties – Section 6**

- 22** Sections 6.2 and 6.3 of SoPC relate to Service Provider due diligence and Local Authority warranties. In social care PFI projects it is not common practice to provide any warranties except in relation to employee information and, possibly, property related matters. However, Local Authorities should have regard to the criteria listed in paragraph 6.3.1 of SoPC where

the granting of warranties would help to reduce the Service Provider's costs. However, if the Local Authority gives a warranty, it will be liable for damages/compensation arising from the inaccuracy of any information that is warranted, and therefore the Local Authority should balance this increased risk against any potential reduction in the bidders costs (and thus the Service Payment).

- 23** Section 6.3.3 of SoPC includes required drafting for a typical exclusion for contracts in which warranties are not given by the Local Authority. This required drafting has been included in the Model Contract.

### **Benefit of Surveys and Reports – Section 6.4**

- 24** This section of SoPC deals with surveys and reports. Latent defect risk is only applicable when existing facilities are taken over by the bidder and is not covered by the Model Contract.

- 25** However, the guidance on obtaining more detailed survey information is relevant to (e.g.) site surveys. The options are:

25.1 the Local Authority can commission more detailed surveys. If this option is followed, the Local Authority should agree the specification and appointment with the short-listed bidders and either ensure that the survey can be novated or transferred to the successful bidder, or that an appropriate warranty is available in its favour. The successful bidder should in turn reimburse the Local Authority for the costs of the survey (if this represents value for money);

25.2 an alternative may be for the short-listed bidders to jointly commission, and pay for, surveys to their specification, perhaps with the successful bidder reimbursing the other bidders;

25.3 if the short-listed bidders (and their financiers) are unable to agree on the scope and terms of reference for the survey work (which is unlikely) each bidder can undertake any survey it feels necessary.

- 26** If the Local Authority believes the bidders due diligence costs could be reduced by the carrying out of a survey (and the reduction in bidder costs is reflected in the bids) then the first option is the recommended approach. Local Authorities are reminded of the need to comply with the Procurement Regulations if they are to be involved in the appointment of the surveyor (and the value of the appointment exceeds the relevant threshold) and to avoid inadvertently taking back risk. Local Authorities should not warrant the survey.

### **Price and Payment Mechanism – Section 7**

- 27** Section 7 of SoPC contain principles and approaches for dealing with structuring the payment mechanism. This is a new section providing new or substantially updated guidance on the development and calibration of payment mechanisms and on the use of User Satisfaction Surveys.

- 28** Section 7.2 sets out the key features of a payment mechanism and emphasises that it is not generally appropriate to "sculpt" the Unitary Charge other than for relevant general price changes or to ensure consistency with any ramp-up in services in an initial phase or project phasing.

- 29** Section 7.3 sets out principles to be applied in structuring the payment mechanism and Section 7.5 discusses calibration. Note that Section 7.4 (*Usage Base Systems*) is not relevant to PFI social care projects.
- 30** The Local Authority should not seek compensation in addition to making deductions from the Service Payment. Section 7.8 of SoPC sets out suitable drafting to avoid double claiming by the Local Authority. This has been incorporated into the Model Contract.
- 31** Section 7.9 of SoPC deals, in particular, with user satisfaction. This will be of relevance and the Local Authorities should carefully consider how they can incentivise the Service Provider to deliver the Services to a high standard.
- 32** Local Authorities are already under a statutory duty to secure continuous improvement i.e. the best value duty and the Model Contract includes best value provisions. Under the best value duty, there is an obligation to carry out user satisfaction surveys. SoPC suggests that Local Authorities impose sanctions for poor user satisfaction, as illustrated by a poor response to a survey.
- 33** Various approaches are set out in Section 7.9.6:
- making direct financial deductions;
  - awarding performance points;
  - imposition of a remedial plan;
  - carrying out of a performance audit;
  - linking deductions to complaint/calls to the helpdesk.

However this has not been incorporated into the Model Contract or the Payment Mechanism.

### Availability Requirements - Section 8

- 34** Section 8.2 of SoPC provides guidance on defining Unavailability. Whilst defining Unavailability for a new social care facility is relatively straightforward, it can be more complex when existing facilities are to be refurbished. This is not covered by the Model Contract or the Model Payment Mechanism.
- 35** Section 8.4 of SoPC provides guidance on Availability and the weighting of critical areas. Where certain areas of the social care facilities are inter-related, both areas would be deemed to be Unavailable if one of these areas was Unavailable. This is covered by the Model Payment Mechanism.
- 36** Section 8.8 of SoPC refers to areas which are Unavailable but Used. The concept of Unavailable but Used is covered by the Model Payment Mechanism.

### Performance Requirements – Section 9

- 37** Section 9 of SoPC includes guidance on setting the performance levels as well as on monitoring of sub-contractors and consequences of poor performance.
- 38** Section 9.3 deals with replacement of sub-contractors.

### Payment Mechanism, Management and Monitoring – Section 10

- 39** Section 10 provides new or substantially updated guidance on contract management, monitoring against the payment mechanism, commencement of monitoring, who does the monitoring, who pays for the monitoring and the reporting of the results of the monitoring.
- 40** It is important that the performance monitoring regime functions effectively. Both parties will bear the costs of their own monitoring except where the Local Authority has to carry out increased monitoring. The Model Contract and Model Payment Mechanism allows the Local Authority to undertake additional monitoring where the Service Provider has been fraudulent in the submission of monitoring reports or has submitted erroneous monitoring reports. In such instances the Service Provider pays for the additional monitoring costs.

### Maintenance – Section 11

- 41** Section 11.1 of SoPC includes required drafting on maintenance which has been incorporated into the Model Contract.
- 42** Section 11.5 of SoPC includes required drafting on surveys, which has been incorporated into the Model Contract. As required by SoPC, the Model Contract sets out the standard that the Facilities must attain throughout the Contract Period. The Local Authority has the right (if it reasonably believes the Service Provider has not attained such standards) to carry out a survey, but no more than once every two years. If the survey shows that the standards have not been satisfied then the Service Provider is obliged, at its own cost, to carry out the necessary rectification works.

### Payments and Set Off - Section 12

- 43** Section 12.3 of SoPC includes suggested drafting on set-off. Section 12.4 of SoPC includes required drafting on VAT. This drafting has been incorporated into the Model Contract.

### Change in Service – Section 13

- 44** This is a new section replacing Section 12 of SoPC3 and sets out a new approach to Service Change. It provides guidance on:
- the purpose of Change Procedures and an introduction to them (13.1);
  - a typology of Change Procedures (13.2);
  - the development of Change Protocols for contracts (13.3);
  - transparency of pricing and Value for Money (13.4); and
  - contract management (13.5).
- 45** 4ps are developing a model accommodation based Change Protocol which will be published in the Autumn for consultation. However this may need to be tailored to reflect the particular issues arising in the social care market. Where Projects are in procurement, Local Authorities should take advice from its legal advisers on how to manage change issues in the Project Agreement and during the competitive dialogue process. Local Authorities should contact the 4ps for the most up to date position on the Change Protocol drafting.

### Change in Law – Section 14

- 46** Section 14 of SoPC deals with the definition and allocation of Changes in Law. SoPC recommends that Discriminatory and Specific Changes in Law should be a Local Authority

risk. General Changes in Law are a Service Provider risk during the construction phase or to the extent the Change in Law is foreseeable and thereafter the capital consequences are a shared risk. The Local Government Supplement to SoPC amplifies this approach and allocates Changes in Law relevant to Best Value to be for the cost of the Local Authority.

- 47 The capital costs of a General Change of Law is shared in ratio's set out in the Model Contract. This can be a bid back item or completed by the Local Authority after taking appropriate advice.
- 48 There is a new Section 14.9.3 (*Changes in Tax Law*) which clarifies that Authorities should not provide tax indemnities to contractors.
- 49 Section 14 of SoPC includes required drafting on Change in Law which has been incorporated into the Model Contract.

### Price Variations – Section 15

- 50 Section 15 of SoPC has been substantially updated to reflect the importance of market testing services rather than benchmarking services, as set out in HMT's "*PFI: Strengthening Long Term Partnerships*" document.
- 51 Section 15 contains principles and approaches for dealing with price variations, including indexation and market testing. These issues are relevant to Local Authority social care PFI projects and projects in operation or procurement have included benchmarking and market testing for the soft Services.
- 52 Section 15 of SoPC includes suggested drafting on market testing which have been incorporated into the Model Contract. The periods at which a Market Test should take place can be a bid back item.
- 53 Benchmarking is also discussed in Section 15.5 but the drafting is not included in the Model Contract. There is clear guidance from Treasury that benchmarking should not be used as a substitute for market testing.
- 54 The Model Contract does not contain provisions for what happens in the event that there is only one compliant tender or no compliant tenders. There is a footnote against the relevant clause which suggests that the Local Authority and its advisers should consider whether wording should be included dealing with this possibility.
- 55 It is arguable that the obligation to market test is an opportunity for the Service Provider to increase or decrease the cost of providing the Services but all risks associated with the market test are for the private sector to manage. Therefore in the event that there are no compliant tenders, the Service Provider is obliged to continue to provide the market tested service on the same conditions and at the same price as in the previous period, i.e. there is no change to the Unitary Charge.
- 56 The Local Authority will also need to consider what should occur in the event there is only one compliant tender. In some sectors, the contract provides that the Local Authority will instruct the Service Provider how to proceed. So for example, the Local Authority could instruct that the compliant tender be accepted or ask that the market test be repeated.
- 57 SoPC does not offer any guidance on what occurs in these situations. In some PFI contracts, benchmarking is used where a market test has not resulted in a compliant bid. However, in

the light of the Treasury's directive that benchmarking does not offer good value for money for the public sector, this option should be treated with caution.

### Sub-Contracting, Employees and Documenting Changes – Section 16

- 58** The guidance in Section 16 of SoPC on sub-contractors and employees is relevant to a Local Authority social care PFI project.
- 59** Some Local Authority social care PFI projects will involve the transfer of a number of employees under the Transfer of Undertakings (Protection of Employment) Regulations 2006 ("**TUPE**"), either involving the transfer of Local Authority employees or a 'second generation' transfer involving the transfer of employees from an existing Service Provider to a new service provider.
- 60** Bidders will require appropriate information about the qualifications and experience of each potential transferring employee to be made available as part of the bidding process and for an appropriate level of certainty over the numbers and details of transferring employees to be made available. Uncertainty over such details or the absence of such information during the bidding process will affect the ability of bidders to appropriately price their bids. In developing the Model Contract, Local Authorities should also take account of the Code of Practice on Workforce Matters in Local Authority Service Contracts.
- 61** The Model Contract incorporates standard 4ps drafting on TUPE and other employment related issues (including pensions).
- 62** There is a new Section 16.4 (*Changes to Project Documents and Financing Agreements*) which provides guidance on the Local Authority's scrutiny of changes to Project Documents and Financing Agreements. The suitable drafting set out in this section has been incorporated into the Model Contract.

### Assignment – Section 17

- 63** The guidance included in Section 17 of SoPC, relating to restrictions on the Local Authority assigning or transferring its rights or obligations under the contract, applies to Local Authority social care PFI contracts.
- 64** Section 17.3(B) of SoPC includes required drafting on restrictions on transfer of the contract by the Local Authority which has been incorporated into the Model Contract.

### Change of Ownership – Section 18

- 65** Section 18 of SoPC has been updated and deals with the change of ownership of the Service Provider. These issues are relevant to a Local Authority social care PFI projects. The required drafting has been incorporated into the Model Contract.

### Land, Equipment and Other Property Interests - Section 19

- 66** This Section is a substantial rewrite of Section 31 of SoPC3. In particular, it advocates early analysis of the required nature of the Local Authority's interest in the relevant asset (whether land or equipment) and gives guidance on ways to handle the introduction of property to a project, on the disposal of property and on the handling of residual values.

- 67** Section 19 of SoPC deals with the issue of land and property interests. These issues are relevant to a Local Authority social care PFI project. Local Authorities should also consider the guidance contained in this Procurement Pack regarding contract debtor tax structures.

### **Treatment of Assets on Expiry of Service Period – Section 20 and Surveys on Expiry and Termination – Section 23**

- 68** Section 20 of SoPC deal with the options open to a Local Authority at the end of a PFI Contract. Section 20.4 deals with handover provisions for assets that transfer to a Local Authority. The Model Contract includes appropriate drafting in this respect. Section 20.5 of SoPC, which sets a regime for payment by the Local Authority for Assets with an alternative use, has not been incorporated into the Model Contract as it is unlikely to be relevant to social care PFI projects.
- 69** A key issue for Local Authorities to consider will be to identify the 'tests' that are required at the end of the contract term to demonstrate that the specified requirements have been met. The social care projects in operation have specified hand-back requirements in terms of the residual life of the facilities. The choice of hand-back condition is an issue for local discretion and will be partly determined by the affordability of different options.
- 70** Section 23 of SoPC includes required drafting on surveys on termination which has been incorporated into the Model Contract.

### **Early Termination – Section 21 and Calculation and Payment of Early Termination Payments – Section 22**

- 71** The approach set out in Section 21 of SoPC, supplemented by Section 5 of the Local Government Supplement to SoPC, in terms of both events of default and consequences, is fully applicable to a Local Authority social care PFI project.
- 72** The circumstances of Service Provider Default set out in the Model Contract follow SoPC drafting. In particular, significant sub-standard performance in any one month or over, say, a three-month period can lead to termination provided appropriate performance failures have occurred and/or payment deductions made. Persistent, unacceptable level of performance where deductions cannot be made under the payment mechanism can be deemed to be persistent breach which can lead to termination. Appropriate provisions are included in the Model Contract together with a warning notice procedure which prevents "hair trigger" terminations.
- 73** Where the deductions from the Service Payment is lower than the cost of rectification, there is a need to ensure that the entire social care service receives an acceptable standard of performance. No parts of the social care service should have to suffer unacceptable standards over a sustained period. In such circumstances it is not appropriate to 'take-back' parts of the Services and the payment mechanism and the contractual arrangements must ensure that such a situation can be dealt with, such as through the ratchet system of payment deductions and/or the award of performance points.
- 74** Funders may have concerns about the exposure of the whole project funding to termination due to the Service Provider's performance in relation to individual or distinct parts of the Service. There will therefore need to be a clear incentive on the Service Provider to address the needs of the whole social care service included in the contract if there is a risk of termination of the whole contract for their performance in relation to part or parts of the Services. In this way, the interests of the Local Authority, the Service Provider and the

fundings, are consistent, as the incentive on the Service Provider to prevent persistent poor performance on individual or distinct parts of the social care service is maximised.

- 75** Sections 21 and 22 of SoPC include required drafting on early termination and calculation and payment of early termination payments respectively. This drafting has been incorporated into the Model Contract, taking account of the issues raised above.

### **Indemnities, Guarantees and Contractual Claims – Section 24**

- 76** Section 24 of SoPC deals with the issues of indemnities, guarantees and contractual claims. These issues are relevant to a Local Authority social care PFI project.
- 77** Section 24.3 of SoPC states that Local Authorities should not offer a reciprocal indemnity to the Service Provider and this guidance should be followed for social care PFI projects.
- 78** Local Authorities must also consider who should be responsible for users of the social care facilities. In social care PFI projects currently in operation, the Local Authority is often responsible for the acts and omissions of the service users but should not be responsible for visitors or general members of the public. This may be resisted by some bidders and needs to be taken into account when evaluating the bids.
- 79** Section 24.3.8 of SoPC includes suggested drafting on indemnities, which has been incorporated into the Model Contract, and includes a cap in respect of breach of statutory duty only.
- 80** Paragraph 24.3.4 of SoPC advises that a Service Provider should only be permitted to cap its indemnity when it offers value for money. As stated above, SoPC drafting gives a cap in respect of breach of statutory duty. Bidders should not be offered other caps and Local Authorities should strongly resist any request for further caps on liability for claims to be included.
- 81** As noted in paragraph 24.3.7 of SoPC, the Local Authority may be faced with specific issues that require the Local Authority to offer a reciprocal indemnity. This should be requested and other mechanisms considered. If an indemnity is given by the Local Authority it must be limited to the specific issue.

### **Insurance – Section 25**

- 82** Section 25 of SoPC addresses the issue of Service Provider insurance. These issues are relevant to Local Authority social care PFI projects and the Model Contract incorporates the suggested and required drafting on insurance issues.
- 83** The issue of insurance is complex, and the Local Authority's risk management officer should be involved in the drafting and negotiation of insurance issues. It is important for Local Authorities to understand bidders' risk contingencies in respect of insurance and on what basis these are priced.

### **Information and Confidentiality – Section 26**

- 84** Section 26 of SoPC deals with the issues of information and confidentiality in a PFI contract. These issues are relevant to a Local Authority social care PFI project and the Model Contract incorporates the required drafting.

- 85** Local Authorities are also required to consider the effect of the Freedom of Information Act 2000 and the Model Contract incorporates the required SoPC drafting.

### **Intellectual Property Rights – Section 27**

- 86** Section 27 of SoPC deals with the issue of intellectual property rights. These issues are relevant to Local Authority social care PFI projects and the Model Contract includes appropriate drafting.

### **Dispute Resolution – Section 28**

- 87** Section 28 of SoPC deals with the issue of dispute resolution. These issues are relevant to Local Authority social care PFI projects and the Model Contract incorporates the appropriate drafting.

### **Local Authority Step-in – Section 29**

- 88** Section 29 of SoPC deals with the issue of Local Authority step-in. The guidance on Local Authority step-in is relevant to Local Authority social care PFI projects.

- 89** The Model Contract incorporates the required drafting on Local Authority step-in.

### **Miscellaneous Provisions – Section 30**

- 90** Section 30 of SoPC includes suggested drafting on miscellaneous contractual provisions. Where relevant the Model Contract incorporates this suggested drafting.

### **Direct Agreement and Senior Lenders – Section 31**

- 91** Section 31 of SoPC deals with the Direct Agreement. These issues are relevant to a Local Authority social care PFI project and the Model Contract incorporates the appropriate drafting.

- 92** Subordination and related provisions is discussed in Section 31.7 of SoPC. As indicated above, the wording set out in Section 31.7 has not been included, but alternative wording has been used.

- 93** The intention of the Model Funder Direct Agreement (the **Model FDA**) is to minimise the time and costs of dealing with legal issues relating to a PFI scheme. 4ps expects the Model FDA to be used un-amended. However, a certain degree of customisation of the Model FDA will be necessary to ensure it operates effectively alongside the Model Contract and sub-contracts, particularly in respect of certain defined terms. Footnotes have been included to highlight the provisions that may need amendment for this reason.

- 94** The private sector should note that any proposed amendments to the Model FDA will be one of the criteria taken into account by Local Authorities in evaluating a bid response to an Invitation to Continue Dialogue. Any proposed amendments to the Model FDA, save for when such proposed amendments are scheme specific changes supported by strong scheme specific reasoning or highlight genuine drafting errors, are likely to be negatively evaluated.

- 95** The Model FDA is based on the August 2007 standard form version circulated by Partnerships for Schools and used in the Building Schools for the Future draft. It has been approved by Partnerships UK and as such has the benefit of PUK's experience in other sectors. It is also

SoPC4 compliant and 4ps are strongly of the view that Model FDA should be acceptable to both Local Authorities and bidders.

- 96** The Model FDA contains a number of footnotes. These are intended to assist understanding or to highlight areas where the Model FDA will require minor amendments for consistency with other project documents. The Model FDA must be analysed and reviewed in detail to ensure that its terms (and their impact) are clearly understood by the relevant parties. The footnotes should be removed before finalisation of the document for execution and (where appropriate) release to bidders.
- 97** The Model FDA is not a replacement for independent, specialist advice and Local Authorities should ensure that it takes appropriate legal, financial and technical advice in using the document.

### **Competitive Dialogue and Commitment Letters – Section 32**

- 98** Section 32 of SoPC has been updated to take account of the competitive dialogue procedure. Section 32.3 sets out a form of commitment letter which should be used by the Local Authority. The guidance is relevant to a Local Authority social care PFI project and the Local Authority should ensure that the guidance is followed as part of selecting the preferred bidder.

### **Due Diligence over Sub-Contracts and Financing Documents – Section 33**

- 99** Section 33 of SoPC deals with due diligence over sub-contracts and the financing documents. These issues will be relevant to Local Authority social care PFI projects, particularly as on an early termination of contract, the Local Authority may be liable for Sub-Contractor Breakage Costs.
- 100** New guidance is given on breakage costs at Section 33.3.1. Local Authorities should be aware that due diligence on the sub-contracts is important and Local Authorities will need to take legal and financial advice on these issues. Local Authorities should request the anticipated levels of Sub-Contractor Breakage Costs, especially the profit element, as part of the competitive dialogue process so that this element can be evaluated.

### **Refinancing – Section 34**

- 101** Section 34 of SoPC deals with the issues of refinancing. These issues will be relevant to Local Authority social care PFI projects and the Model Contract incorporates the required drafting from SoPC.

### **Financial Robustness: Contractor Distress - Section 35**

- 102** A new section has been included providing guidance on Contractor distress and, in particular:
- Section 35.1 looks at structural protections from Contractor distress;
  - Section 35.2 looks at project robustness;
  - Section 35.3 looks at contractual robustness;
  - Section 35.4 looks at managing Contractor distress.

All of this is relevant to Social Care PFI projects.

### **Bond Finance - Section 36**

- 103** This is a new section providing an introduction to the use of bond finance in PFI transactions and setting out permitted provisions to the standard drafting which may be made where bond finance is used. As bond finance is unusual in social care PFI projects, the drafting has not been included in the Model Contract.

### **Corporate Finance - Section 37**

- 104** This section is substantially new and sets out the implications of project and corporate finance. These issues may be relevant to smaller Local Authority social care PFI projects where the Service Provider is using only corporate finance. Local Authorities need to take legal and financial advice on these issues where relevant.

### Contractual Issues not Covered in SoPC

#### Commissioning and Decanting

- 105** Social care PFI projects will probably require mobilisation and commissioning tasks to be carried out prior to service commencement. The Contract will need to set out the tasks that the Service Provider needs to have satisfactorily completed before the Services can commence. The Model Contract includes appropriate drafting to require the parties to agree both pre and post construction commissioning. The aim of an agreed commissioning plan is to ensure the Local Authority has access during the Works Period to carry out any tasks (such as installation of specialist equipment) that it may not wish to contract to the Service Provider. It also ensures that the building is ready for the Local Authority to use as care accommodation and allows the Local Authority to plan the decanting of patients and staff.
- 106** The Local Authority will need to specify in the Model Contract which equipment it will provide and remain responsible for and which equipment the Service Provider must provide, maintain and replace. The Model Contract contains a generic definition of Equipment and Authority Equipment which will need to be made project specific – by example by inclusion of a list of Authority Equipment.
- 107** Although on a project specific basis the Local Authority may provide certain equipment such as beds, the Service Provider will be responsible for maintaining and cleaning such equipment. This needs to be made clear in the Services Specification.

#### Monitoring of the Works

- 108** The Model Contract gives the Authority Representative a right of access to view the carrying out of the Works. Following a viewing, if the Local Authority discovers defects or the Service Provider has failed to comply with the Authority Construction Requirements, the Local Authority can increase its monitoring and the Service Provider will pay the costs of the additional monitoring.
- 109** The Model Contract also gives the Local Authority the right to open up and inspect any part of the Works if it reasonably believes that such part is defective. If the Works are not defective then the Service Provider is entitled to an extension of time but not to any compensation. This may be viewed as unfair by bidders who request that it is a Compensation Event i.e. it is entitled to compensation for any losses incurred as well as an extension of time. This may be better value for money than the bidder pricing for the unknown risk of the Local Authority opening up Works which are not defective. However the Local Authority would not need to require the opening up of the Works if the Service Provider ensured that the Authority Representative (and the Independent Certifier) were given an opportunity to inspect all parts of the Works before they were covered up.

#### Snagging

- 110** The Independent Certifier may issue a Snagging Notice together with the Certificate of Practical Completion. The Model Contract allows the Service Provider twenty Business Days to complete the Snagging, failing which the Local Authority may (after serving written notice) rectify the Snagging Matters itself, at the cost of the Service Provider.

#### Building Manual

- 111** The Model Contract requires the Service Provider to provide the Local Authority with a copy of the Building Manual on completion of the Works. The Local Authority should consider the

definition of Building Manual and ensure that it includes all the documents that the Local Authority requires. In particular, the Building Manual should fit in with the Services Specification and the nature of the documentation that the Service Provider will be required to maintain during the Contract Period.

### Quality Assurance

- 112** The Model Contract includes (in the schedules) a Design and Construction Quality Plan and a Services Quality Plan. The Model Contract requires the Service Provider to comply with these plans and update them over the Contract Period. The Local Authority should ensure that the provisions in the Model Contract are compatible with the Services Specification.

### Service Delivery Plans

- 113** The Service Provider must produce a Service Delivery Plan for each Service. These will form part of the Model Contract. They may be updated from time to time in accordance with the Review Procedure i.e. the Local Authority has an opportunity to review any amendment (and in certain circumstances) object to such amendment.

### Corporate Identity and Signage

- 114** The Model Contract imposes an obligation on the Service Provider to erect hoarding, site boards, plaques and/or other signage where requested by the Local Authority. This should be done at no additional cost although, if it represents better value for money, such works could be designated Small Works and prices included in the Schedule of Small Works Rates.

### Stocks, Consumables, Materials and Equipment

- 115** The Model Contract includes provisions as to the standard and quantity of goods equipment and consumables. There are also provisions dealing with the storage of hazardous materials.

### Community Use

- 116** The Model Contract includes a right for the Local Authority to use the Facilities for Community Use for a specified number of hours each Contract Year.
- 117** The number of hours will be specified on a project specific basis. The Local Authority may use the Facilities for Community Use outside the specified number of hours but this will constitute an Authority Change i.e. the Local Authority may have to compensate the Service Provider any losses it suffers as a result of such use.
- 118** The Service Provider is obliged to provide the Services required during Community Use to the extent set out in the Services Specification.

### Third Party Use

- 119** The Model Contract includes provisions whereby the Service Provider may, with the prior written consent of the Local Authority, enter into arrangements for Third Party Use. The Service Provider shall charge for Third Party Use and income earned will be shared with the Local Authority. The Local Authority's share will be a bid back item.
- 120** The Local Authority should decide on a project specific basis whether it is appropriate for the Facilities to be available for Third Party Use.

### Best Value

- 121** The Model Contract includes provisions dealing with the Local Authority's Best Value Duty including the carrying out of a Customer Care Survey.
- 122** The obligations set out in the Model Contract are also referred to in the Services Specification and failure to carry out the Best Value related obligations set out in the Model Contract may lead to deductions from the Service Payment.

### Local Government (Contracts) Act 1997

- 123** The Model Contract includes provisions for what happens if the Certification Requirements are not satisfied and includes the relevant discharge terms. If a Local Authority cannot issue a Certificate within six weeks of the date of the Agreement then the Service Provider will be paid as if the Contract was terminated for Authority Default.

### Energy

- 124** The provision of energy is clearly not unique to a social care PFI project and issues arise in relation to:
- 124.1 volume of use - how many units of energy (kWh) is needed to operate the Facilities and provide the Services;
  - 124.2 cost per unit; and
  - 124.3 sourcing of the energy purchased.
- 125** In relation to volume of use, the Service Provider will be responsible for providing new facilities and should be incentivised to design and operate the facilities to optimise efficiency of energy use. This Guidance recommends that the Service Provider should manage energy volume risk, as this provides a basis for an integrated contract and ensures the Service Provider is incentivised to take advantage of changes in technology that will bring about energy efficiency gains. The consideration of the installed energy load is critical to the design process and to the management of operational risks over time. The Model Contract requires the Service Provider to design and build to achieve a specified energy consumption level. A proposed system of monitoring is set out. If the specified consumption level is not met the Service Provider must either carry out rectification works or compensate the Local Authority.

### Energy Consumption

- 126** Energy prices have been volatile over the last three decades and Local Authorities are left with a series of choices as to how to manage the risk associated with variations in energy prices during the contract period. Each of these options has different strengths and weaknesses, and Best Value considerations. These need to be carefully considered before determining the most appropriate option.
- 127** The Model Payment Mechanism does not include provisions for the Service Provider to give a consumption forecast or for the payment of utility costs but in some PFI projects the private sector takes consumption risk and the public sector takes price risk. Bidders can be requested to price on the basis it takes all or some consumption risk and/or provide an energy consumption forecast for all or some of the Contract Period. This is a complex issue and the Local Authority will need to consult with its advisers.

- 128** The Model Contract does not include any provisions relating to the sharing of risk in relation to the consumption and cost of the utilities. This will need to be incorporated on a project specific basis.

### Treatment of Existing Utilities Contracts

- 129** If the Local Authority can demonstrate (in accordance with its duty to provide Best Value) that it can achieve more economic prices and that the costs of administration are lower than those of the Service Provider.
- 130** The Local Authority's existing energy contract(s) may span financial close and service commencement. If the Service Provider is responsible for procuring the utilities under the contract, then the Local Authority should review the value for money offered by the existing contractual arrangements in comparison with those proposed by the Service Provider.
- 131** As part of this review, the Local Authority should consider whether they are able to assign the existing contract to the Service Provider, and/or the impact of early termination including the potential liability of any breakage costs.
- 132** Where the Service Provider can offer a better arrangement than the existing contract, these arrangements should be terminated at a time that achieves the best balance between the costs of termination and the reduced costs of the new arrangements. Where, as a result of competitive pricing or high breakage costs, the existing contract offers better value for money, then it should remain in place until it expires.

### Sourcing of Energy

- 133** An increasing number of Local Authorities are sourcing part of their energy requirements from clean and renewable energy sources. The Local Authority should consider requiring the Service Provider to source all or some of its energy requirements from such sources. Such a requirement will encourage the Service Provider to explore innovative solutions to energy sourcing - for example, on-site generated solar power. Due to the purchasing powers of Local Authorities, it may be better value for money for the Local Authority to manage the provision of clean and renewable energy. Wording is not included in the Model Contract but the issue may be covered by the Energy Management Service.

### Contractor Debtor

- 134** The contract debtor structure should be acceptable for tax purposes on a social care PFI project and results in significant savings being made over the life of a project. The contract debtor structure envisages that the Service Provider will not have any interest in a site, but rights of access (like a traditional contractor) to carry out its duties and obligations by way of a licence.
- 135** The Model Contract assumes the contract debtor structure will be adopted.

### Value Added Tax

- 136** This is a general outline of the potential supplies for VAT purposes that may arise in the provision of local authority social care services. VAT can represent a material additional cost on any social care PFI project and this Procurement Pack should therefore not be relied upon.
- 137** The first question to address is which party is making the supply of the social care facilities to the user and it is important that the documentation reflects the intention of the parties.

Under a social care PFI project, Local Authorities will pay the Service Payment to the Service Provider in consideration for the provision and operation of serviced accommodation. This represents a standard rated supply by the Service Provider and VAT will be payable by the Local Authority in addition to the Service Payment. The Model Contract which provides that all sums due under the contract are exclusive of VAT. Accordingly, where VAT is payable the supplier is required to issue a proper VAT invoice to the recipient of the supply.

- 138** VAT suffered by a Local Authority in connection with any business activities carried on by it will be recoverable provided that the VAT can be attributed to a taxable supply made by the Local Authority. There is no entitlement for a Local Authority to recover VAT charged to it in respect of its non-business activities. In a social care PFI project, Local Authorities may seek to rely on the refund scheme for non-business activities governed by section 33 of the Value Added Tax Act 1994 ("**VATA**"). Broadly, section 33 provides that a Local Authority can recover any VAT charged to it in relation to the provision of goods and service provided that the provision of such goods and services is not for the purposes of a business activity carried on by it.
- 139** In considering the VAT position, the Local Authority should make reference to the long standing Memorandum of Understanding ("**MOU**") between HM Customs & Excise (now HM Revenue and Customs) and the Chartered Institute for Public Finance and Accountancy. The MOU sets out the various scenarios relating to the provision of social care services and their VAT consequences.<sup>1</sup>

### Sub-Contractors in the Construction Industry Scheme

- 140** There is still considerable doubt whether, and if so to what extent, the CIS applies to PFI projects generally. Whilst most PFI projects involve a material element of construction, and therefore the scheme would seem to apply, there are strong arguments that what the Local Authority is actually paying for is an ongoing service, provided by a service provider. HM Revenue and Customs have yet to publish any definitive guidance on this although an amendment to the current draft legislation accepts from the operation of CIS any payments which a public body makes under a PFI project. This is clearly welcome news but, pending implementation of the new scheme, general practice is to include contractual provisions to cover the operation of the existing scheme.
- 141** The Model Contract contains suitable drafting which seeks to give the Local Authorities comfort that should HM Revenue and Customs insist on the operation of the CIS, the Local Authority has contractual rights to make relevant deductions from the service payment as and when required to do so by law, subject to the provision by the Service Provider of the necessary documentation to enable the authority to make the payments without the deductions.
- 142** The legislation governing the CIS Scheme is set out in Chapter 3 of Part 3 of the Finance Act 2004, the Income Tax (Construction Industry Scheme) Regulations 2005 and the Income Tax (Construction Industry Scheme) (Amendment) Regulations 2007. This came into force in April 2007 and replaced the previous legislation. The drafting in the Model Contract reflects the new legislation.

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<sup>1</sup> This MOU maybe subject to change following the recent VAT and Duties Tribunal decision (which found in favour of the appellants) in the joined appeals of Edinburgh Social Leisure, South Lannockshire Leisure and Renfrewshire Leisure.

### Grossing-up of Payments

- 143** It is envisaged that where a termination results from default by the Local Authority, force majeure or corrupt gifts or fraud, the termination payment to the Service Provider is subject to taxation in the hands of the Service Provider. The Local Authority would gross-up the payment so that the Service Provider is left with the same amount of money after payment of that taxation as it would have had, had the payment not been subject to any taxation.
- 144** This is to ensure that, as far as possible, the intended purpose of the termination payment is satisfied; that is that the Service Provider and its financiers are fully compensated, that the financial consequences of termination be shared or that senior debt is repaid, depending on which termination event applies and what has been commercially negotiated between the parties.
- 145** Grossing-up should also apply to any payments by way of indemnity or compensation made by the Service Provider to the Local Authority.
- 146** The payment should take account of any relief from taxation available to the Service Provider that have been derived from the particular PFI project in the usual way, and subject to the financial model. Clearly, if the Service Provider has priced the project on the basis that tax relief is available for surrender to group companies, then the Local Authority will already have had the benefit of that relief by way of a lower Service Payment. It should therefore still gross-up the termination payment accordingly. Grossing up provisions are included in the Model Contract.