PFI/PPP DISPUTES

By Peter Sheridan

FOREWORD

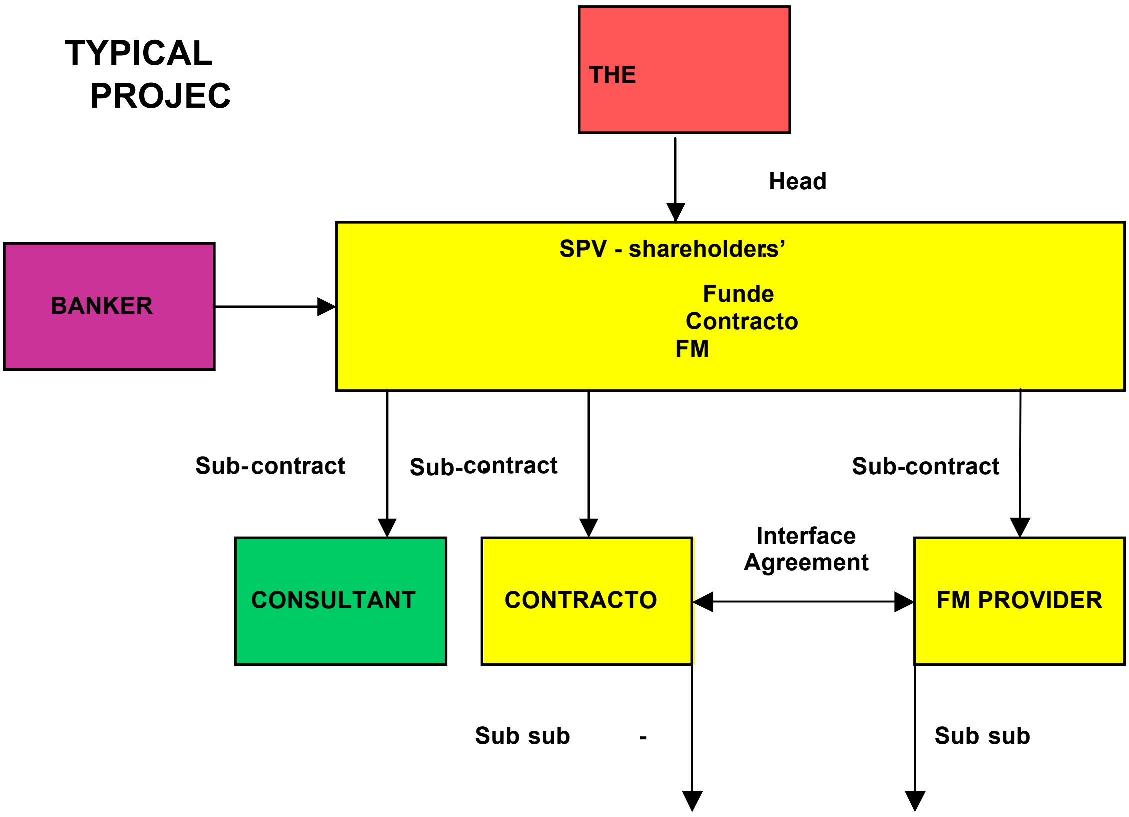
It is now over 14 years since the first Public Finance Initiative/Public Private Partnership ("PFI/PPP") projects were completed in the UK and there were, as at the end of 2008, some 935 PFI/PPP projects worth over £66 billion. The number of projects and the time over which they have been operating enable some assessment to be made of where problems are emerging or are likely to emerge and what the nature of those problems is likely to be.

The market has changed between 2008 and 2010 as the UK and global economies have declined. The "credit crunch", *i.e.* the sharp reduction in bank lending as a result of banks' substantial losses, has had the obvious effect on PFI projects of a decline in bank lending to the private sector. This has led to the government in the UK providing funding for projects for which private finance is no longer available, so that, paradoxically, "private finance initiative" projects may proceed without or with reduced private finance. There has also been a reduction in new PFI/PPP projects. Nevertheless, there still exists a substantial PFI/PPP market in the UK.

In a typical PFI project, the head contract is an agreement between an organ of government ("the Authority") and a consortium whose task it is to design, build and operate the project. This consortium will typically consist of a funder, a construction company and a facilities management company, often in the form of a limited company special purpose vehicle formed solely for the purpose of the project ("SPV"). The SPV will itself have a contract regulating the relationship between its members (a shareholders' agreement). The SPV will enter into various sub-contracts for the performance of the project, usually including a sub-contract with its contractor member for the construction of the project (and often also for the design of it) and its facilities management ("FM") provider member for provision of management services for the duration of the project, often 25-35 years. These SPV member sub-contractors will in turn enter into sub-sub-contracts for various aspects of the performance of the project.

Outside this vertical structure, there will be commercial bankers providing funding of the project to the SPV. The SPV absorbs the costs of bidding for and winning the project and designing and constructing it. The SPV then receives fixed payments (the "Unitary Charge", which is subject to some adjustment in some circumstances) for the duration of the project (say 30 years). These payments cover all the bidding costs, capital costs, operating costs, financing costs and the profits of the SPV members.

TYPICAL PROJEC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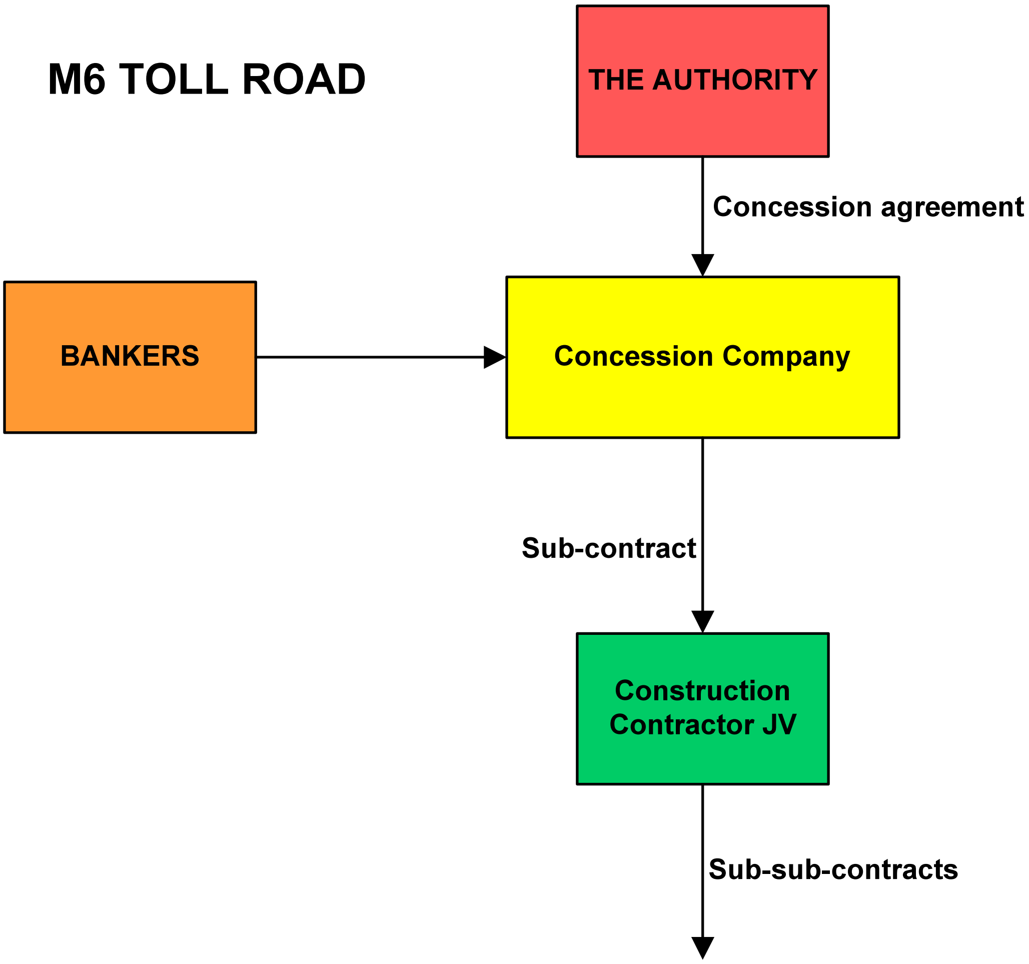
M6 TOLL ROAD


THE AUTHORITY
Concession agreement
BANKERS
Concession Company
Sub-contract
Construction Contractor JV
Sub-sub-contracts

The typical structure described in Figure 1 is not always applicable and different structures will give rise to different relationships between the parties to the project. Figure 1 shows the typical model as described above and also by way of comparison Figure 2 shows the model for the M6 toll road, a UK project discussed further below.

All of these contractual relationships, like any other, may give rise to disputes. That is not to say that PFI/PPP projects are particularly prone to disputes nor that other methods of procurement are immune from disputes. To date, PFI/PPP projects have not been dispute-ridden, nor is it anticipated that they will be in the future. However, disputes can and do arise and the entities involved will require a contractual framework best suited to the management and avoidance of those disputes.

General Introductory Matters

Different types of dispute, possible future trends, the normal contractual provisions for dealing with them and means of avoiding or managing these disputes are considered below.

It has been convenient to use acronyms, abbreviations and words with a defined meaning (identifiable by the use of a capital letter), a list of which appears at the end.

Space has not permitted a detailed discussion of the shareholders' agreement, regulating the relationship between members of the SPV. Careful consideration should be given here to clear risk allocation and, when it comes to dispute resolution, a tiered system such as is discussed below in relation to the head contract may also be considered. The issue of conflict of interest where the same individuals are board members of the SPV and another company involved in the project, *e.g.* the contractor or FM provider, is considered below.

General market factors tending against disputes and factors which may lead to disputes are considered below. By way of background to the more detailed discussion which follows, some introductory explanation of common types of dispute resolution in PFI/PPP-related contracts, covering their main features is then set out. There is then a consideration of the normal dispute resolution provisions in PFI head contracts, by reference to the current Treasury standard form, SOPC4, and also to the Centre for Effective Dispute Resolution ("CEDR") dispute resolution procedure for PFI and long-term contracts.

After considering these agreements, the writer proceeds to consider dispute-related issues concerning sub-contracts entered into by the SPV, including equivalent project relief ("EPR") provisions. The following topics, which are identified as potential areas for PFI/PPP disputes, are also discussed below: SPV or contractor/FM provider sub-contracts with consultants; bid costs; public procurement issues; and benchmarking and market testing. The writers conclude with some guidance on areas of caution and dispute avoidance for the various participants in PFI/PPP projects.

FEATURES TENDING AGAINST DISPUTES

Disputes between the Authority and the SPV are unusual; the March 2006 Treasury report recorded that the dispute resolution procedure has been invoked on few projects, attributing this to "the fact that relations are strong enough to be able to resolve issues without normally needing to resort to dispute resolution. With a typical duration of 30 years, a PFI/PPP project promotes long-term relationships. Similarly, the SPV participants have a long-term commonality of interest and are unlikely to have disputes between themselves.

Because the SPV's funding is provided by bankers who have a close interest in the proper planning of the project and its contractual documentation, PFI/PPP projects are typically the subject of a high degree of design work prior to the construction phase, high quality budgeting, careful analysis and costing of risk and detailed and thoroughly considered contractual obligations. These are factors tending against disputes at the construction phase, which on traditional procurement has been a fertile area for contractors' and sub-contractors' claims.

Broadly speaking, PFI/PPP projects can be broken down into three phases: the procurement phase, the construction phase and the operation and maintenance phase. The construction phase is traditionally in particular a likely source of disputes. Time and cost over-runs are some of the most common sources of dispute in conventionally procured construction projects.

In October 2009, a National Audit Office report ("NAO") "Performance of PFI Construction" found that 94% of PFI projects surveyed were delivered on, or less than five per cent over, price. Only 35% of projects came out above the originally contracted price and 31% were delivered late. A sample was also taken of public sector non-PFI projects, of which 46% exceeded the contractually agreed price and 37% were late. These figures were broadly in line with data on non-PFI projects gathered by other bodies such as the OGC and Constructing Excellence.

This does not mean that PFI/PPP projects are delivered at a lower cost or more quickly than traditionally procured projects, but it indicates more accurate pricing and programming at the outset and, therefore, less likelihood of disputes.

Disputes over contractor final accounts, for example, are uncommon with PFI projects. This is partly as a result of provisions in PFI/PPP construction contracts which typically restrict building contractor delay compensation and time relief to what are described as "compensation events", "relief events" or "force majeure". These events are normally much more narrowly defined (and may exclude time and money and/or relief from liquidated damages) than traditional "relevant events" and "loss and expense" claims under the common standard form construction contracts.

One of the reasons for this is the commercial pressure applied to contractors and the SPV by the banks and lenders through the security package.

PFI/PPP projects also call for construction requirements to be specified at an early stage in the project which minimises the prospect of a work scope change during the construction period - an event that often creates disputes with conventional procurement. Furthermore, the influence of private finance (the banks and investors) results in a more rigorous specification and costing of the construction phase, pre-contract. Additionally, the construction contractor will frequently be a shareholder in the SPV and will thus have a direct interest in ensuring that the construction phase is completed on time and to budget.

It should be borne in mind that profit margins have been considerably higher for the construction phase with PFI/PPP projects than with traditional procurement. One to two per cent is a normal profit margin with traditional procurement, whereas six to eight per cent has been normal for PFI/PPP projects. The thin margins in traditional procurement has led to a claims-orientated industry whereas conversely dispute avoidance is easier where profit margins are more generous.

The fact that long-term relationships are established by PFI/PPP projects (typically for 25-35 years) and that the FM providers or their associated companies frequently have equity stakes in the SPV, means that potential claimant parties have a much greater willingness to take a "whole life approach". Consequently, disputes that might arise during the operation and maintenance phase of the project are likely to be approached with a greater sense of collaboration than disputes under standard contracts. The SPV may exert pressure upon an aggrieved FM provider to settle claims for changes to its remuneration, driven by a fear of adverse benchmarking or market testing during the course of the contract and the potential threat to its income arising from it.

Over the past 14 years extensive development, review and refinement of project documentation has taken place. Many hundreds of lawyers, financiers, government departments and construction and operations professionals have reviewed, tested and refined the agreements which establish and govern the relationships between the parties on PFI/PPP projects.

In the UK, a standardisation of PFI/PPP project agreements has taken place which has resulted in a set of mechanisms being set out and made publicly available by the government, along with guidance notes and assistance offered for parties seeking to engage in this procurement model. The PFI/PPP procurement model has now been adopted in many countries around the world and those countries have been able to acquire the benefit of the development which has taken place in the UK to streamline and improve the effectiveness of the model.

One example of the refinement in the contract mechanisms which has taken place is in relation to dispute resolution, where the relevant provisions have been designed to prevent and dissuade parties to PFI/PPP projects entering immediately into litigation or arbitration.

There has been a recognition that tiered dispute resolution provisions, in which typically the initial phases require senior executive negotiation, assist in providing parties with flexibility to try and resolve low value or less important problems more swiftly and with lower costs and management time than those common under more traditional forms of contract. This, in conjunction with the pressures created by the security package required by the lenders and banks, frequently acts as a stimulus to settlement or early resolution of disputes.

WHERE DISPUTES MAY ARISE

There has been an increase in the number of PFI/PPP disputes over the last three years or so. In recent years, the PPP project to have received the most publicity, albeit such publicity has been mostly negative, has been the London Underground refurbishment PPP. This publicity was almost entirely due to the collapse of the maintenance provider Metronet. Notably, however, Metronet's collapse has only resulted in two reported cases.

Disputes may arise under any of the contractual relationships referred to above, but, it is suggested, are more likely to occur as a result of particular factors as follows.

The very fact that bespoke contracts and sub-contracts are and have been frequently used can give rise to genuine differences between parties as to the meaning that was intended in what can be complex provisions. The fact that there is a lengthy contractual chain, down which the parties will attempt to pass back-to-back obligations, can also give rise to difficulties. Particular problems with "equivalent project relief" ("EPR") provisions are considered further below. Parties further down the contractual chain may also be less closely connected or indeed quite unconnected with the long-term relationships formed higher up the contractual chain. The development of a secondary market tends to diminish the effect of the potentially long-term relationships formed at the start of a PFI/PPP project.

Contractor/FM Provider Not Part of SPV

The contractor and FM provider need not be part of the SPV, although, as stated above, they often are. Where they are not, it can be seen immediately that one of the factors tending against disputes is absent.

To illustrate this point, the Birmingham Relief Road, or M6 toll road as it is now known, is a major PFI/PPP project (the largest UK road contract, worth £900m) which gave rise to major disputes at the construction stage. Some of the matters which were in dispute are discussed below.

Midland Expressway Limited (MEL) has the government concession to design, build and operate the 27 miles of the M6 toll road until the year 2054. MEL is a private company wholly owned by the Macquarie Infrastructure Group. It is in substance as well as legally an entirely separate entity from the consortium of construction companies engaged by MEL to design and build the toll road. The commonality of interest between the SPV and the construction companies present in the typical model was absent in this project. Whether or not as a result of this, there have been numerous weighty adjudications covering a large range of issued, four reported decisions in the High Court (one of which in particular is discussed below) and one decision in the Court of Appeal.

The Secondary Market

A significant secondary market has developed, in which SPV members may sell their stake in the consortium to another investor. A contractor, for example, may, after completion of the building work, sell its stake to generate cash for its construction business, rather than remain a long-term investor over a period of, say, 30 years. Substantial sums can be raised and channelled into the company's core business. Contractors are often thinly capitalised and have a need to release equity and profits by sale. Some, however, with deep equity pockets have been able to shift their business to the investment side of this market.

Similarly, an FM provider, though its primary business is long-term facilities management over similar periods, may wish to remain involved only as a sub-contractor to the SPV for the provision of the facilities management and not as a long-term investor in the SPV. Even a funder may wish to sell its stake and invest elsewhere. The SPV, by investing time, money and effort in successfully winning the project, has created a valuable asset which can be traded in the market, or individual stakes in it may be sold. Conversely, the secondary market creates the opportunity for other investors to enter into the PFI/PPP market by buying into projects that are already won and under way.

Once the SPV has landed the project and the construction phase is complete, these projects offer major long-term investors, including pension funds, a very low risk long-term predictable income. An example illustrating the importance of the secondary market for both buyers and sellers is Carillion's sale of its stake in eight PFI projects, including prisons, schools and court houses in 2006. These stakes had a book value of £24m, but Carillion reportedly sold them for £46m to the Secondary Market Investment Fund and Infrastructure Investors, to net a profit of £22m. Carillion's overall pre-tax profit before exceptional items was reportedly just £24.7m.

When, for example, a contractor or an FM provider has sold its stake in the SPV, it can be seen immediately that one of the factors tending against disputes has been removed, since the relationship between the SPV and the contractor or facilities manager is now purely at arm's length, rather than the contractor or facilities manager also being a member of the SPV. As a practical point in addition, the original parties will have had a thorough and, usually, a common understanding of what was actually intended by the wording in the contractual documents, whereas a new party may take a different view. Bespoke contracts dealing with complex matters will inevitably give rise to possible different constructions.

State of the Art Projects

> **A contract relating to the design and construction of new facilities at a science laboratory in Teddington, the National Physics Laboratory, became the first PFI/PPP project to be terminated for non-performance, a situation which often gives rise to serious disputes. This was an early, pre-standardisation project, signed in 1998 between the Authority, Department of Trade and Industry and the SPV, Laser (made up of John Laing and Serco). The project was apparently divided into 12 separate construction phases and the technical design was so complicated that Laser had problems meeting the project's specifications. Concerned at what appeared to be financially open-ended design difficulties, both**

parties agreed to termination of the contract at the end of 2004. Although the senior debt (long-term debt) was paid off and the public sector paid nothing else, the private sector reported a loss of £100 million. One lesson appears to be that where projects are particularly technically complex, it is important for the public sector to test out the private sector's designs to ensure that they will function effectively. It is, more fundamentally, highly questionable whether projects involving the development of complex designs are suitable at all for PFI/PPP projects. While design is being developed, it is not feasible to arrive at a reliable price, which is normally one of the positive features of PFI/PPP. In this respect, complex design projects are similar to IT deals, which are already recognised as not suitable for PFI/PPP, as they are characterised by rapid change and development.

The London Underground refurbishment PPP project may be another example of works not best suited to the PPP model, for similar reasons, in that the risks were not clearly identifiable in advance of the placing of the contracts.

TYPES OF DISPUTE RESOLUTION

Negotiation

It is quite usual in PFI/PPP contracts for a cascade of dispute resolution options or obligations to start with a provision to the effect that the parties will negotiate in good faith in an attempt to settle their dispute.

An obligation to conduct negotiations of this type is little more than an attempted formalisation of a step almost always undertaken in any case as a matter of business sense. Historically, in legal terms, an obligation to attempt to negotiate is normally ineffective, as it is void for uncertainty. The difficulty with such an obligation is that it is difficult to specify with any precision what the content of a negotiation would have to be for the obligation to negotiate to be discharged. The courts decline to compel parties to comply with these provisions because of "the practical and legal impossibility of monitoring and enforcing the process" (see *e.g. Halifax Financial Services Ltd v Intuitive Systems Ltd* [1999] 1 All ER (Comm) 303, [1999] CILL 1467; *Walford v Miles* [1992] 2 AC 128, [1992] 2 WLR 174). Notwithstanding the above, the decision of the Court of Appeal in *Petromec Inc Petro-Deep Societa Armamento Navi Appoggio SpA v Petroleo Brasileiro SA* [2005] EWCA Civ 891, [2006] 1 Lloyd's Rep. 121 suggests that clauses in concluded contracts which provide that parties should negotiate in good faith may in some circumstances be enforceable and may point the way to some development of this area of the law. However, the *Petromec* case falls short of illustrating the circumstances when one party may legitimately withdraw from such negotiations, and, accordingly, the law in this area remains unclear. *Petromec* cannot alter the rule in *Walford v Miles*, which is a House of Lords decision and was binding on the Court of Appeal in *Petromec*.

What provisions of this type ("agreements to agree") do is provide a statement of intention to resolve disputes amicably if possible, which is of course normally the best course from the point of view of minimising cost and disruption and also maintaining good relationships. Whether the provision is legally enforceable will depend on its exact terms.

Mediation

A mediation is also a negotiation in which the parties attempt to settle their dispute, but in a mediation the added ingredient is a mediator, an independent third party whose task it is to assist the parties in concluding a settlement. A mediation is conducted on a without prejudice basis and if the parties are not successful in concluding a settlement, it is of no effect.

Mediation is, it is suggested, potentially eminently suitable for PFI/PPP disputes, where direct negotiation in good faith has not been enough, in that it is a flexible dispute resolution method, which can accommodate any number of parties and issues, is confidential, allows parties to control the process and to dispose of issues promptly. It is also designed to allow parties to settle their disputes amicably, without prejudicing long-term relationships. However, it does not in practice feature routinely in PFI/PPP contracts.

Although a mediation is a negotiation, assisted by a third party, an agreement to mediate may legally be in a different category from the type of agreement to negotiate referred to above, where the parties agree to negotiate with one another in good faith. Where the parties have not only agreed to negotiate but also gone a step further by identifying a particular procedure, such as the CEDR mediation procedure, there is sufficient certainty for a court to ascertain whether the parties' obligations have been complied with or not: see the *Cable & Wireless Plc v IBM United Kingdom Ltd* [2002] EWHC 2059 (Comm), [2003] B.L.R. 89. The reason for this distinction is that where there is a clear procedure, as opposed simply to an agreement to negotiate with no specific procedure, the court can investigate and see whether the specific steps the parties have agreed to take have or have not been undertaken. Accordingly, an obligation to mediate can have real and effective force. Furthermore, although mediations do not by any means always succeed, they can prove effective even where one party is an unwilling participant at the start.

Parties to court proceedings are strongly encouraged to consider alternative dispute resolution, including in particular mediation, and failure to do so can lead to being penalised by the court on the question of costs, with the result that mediation has become and is likely to remain a significant part of the dispute resolution landscape in the UK.

Adjudication

Adjudication in relation to construction contracts in the UK now usually means a decision made pursuant to statute on a dispute arising under the contract, within strict time limits, immediately binding but generally subject to review in subsequent arbitration or litigation. Adjudication is of particular relevance to the sub-contract between the SPV and the contractor for the construction phase and to the contractor's sub-contracts for that phase. It is also likely to be applicable to the hard services of the FM provider.

The relevant statute is the Housing Grants, Construction and Regeneration Act 1996 ("HGCR Act"), which came into force in 1998. Under section 108(1), a party to a construction contract has the right to refer any dispute arising under the contract for adjudication, at any time. If that right is exercised, adjudication is then compulsory for the other party or parties. Under section 108(3), the decision of the adjudicator is final and binding if the parties so provide (which is unusual) but otherwise is to be binding only until the dispute is finally determined by legal proceedings, by arbitration (if the contract provides for arbitration or the parties otherwise agree to arbitration), or by agreement.

Once a dispute is referred to an adjudicator, the decision of the adjudicator is due within 28 days, which can be extended by up to 14 days with the agreement of the referring party and by further time only with the agreement of both parties. While adjudications frequently overrun the 28-day period, they nonetheless normally remain a quick process compared with other forms of formal dispute resolution.

A statutory Scheme (here called "the Scheme") applies by default if the parties' construction contract does not comply with various requirements as to terms relating to adjudication that must be included in any construction contract, under section 108.

Whether or not a contract is a construction contract under the HGCR Act depends on the provisions under sections 104 -105 relating to agreements which are or are not for the carrying out of construction operations. Where parties do not have a construction contract under the HGCR Act, they are not subject to the statutory provisions concerning adjudication. They may, however, adopt similar provisions for dispute resolution by adjudication as a matter of contract.

The HGCR Act is of relevance in the context of PFI/PPP disputes not only to dispute resolution by adjudication, but also because of its provisions concerning payment. In particular, the rule against pay-when-paid provisions under section 113 of the HGCR Act is considered below in relation to EPR provisions in sub-contracts let by the SPV.

PFI/PPP head agreements are exempt from the provisions of the HGCR Act, by reason of a statutory instrument, SI 1998/648 Construction Contracts (England and Wales) Exclusion Order 1998. The rationale for this exclusion may be that while the perceived ills of the construction industry were considered to make it ripe for legislative control, the government's own PFI/PPP contracts were not considered to be in need of such assistance. This was a political decision which is difficult to reconcile with the principles behind adjudication under the HGCR Act.

Whatever the reason for the exclusion may be, the inclusion of adjudication provisions in PFI/PPP head agreements is not statutory and is purely a matter of contractual choice of the parties. However, when the SPV sub-contracts with other parties for the provision of construction operations (and those parties in turn enter into sub-sub-contracts for construction operations), then the HGCR Act is applicable and in those sub-contracts provision for adjudication is obligatory as a matter of statute. For that reason, adjudication may be included as a matter of contract in the head agreement so that there is consistency throughout the contractual chain.

Expert determination

This is a purely contractual mechanism, so it depends on what provision the parties agree. Normally, a dispute is referred to an individual with some relevant technical or legal expertise for a decision which is both binding and final. The advantages are normally speed, economy and confidentiality. There is also finality, provided the expert answers the question that is referred to him or her, but whether that is an advantage can depend on whose perspective is taken and the quality of the expert and/or his or her decision.

Arbitration

Arbitration is also a contractual mechanism and dependent on the parties entering into an agreement to arbitrate to resolve their disputes or a particular dispute. However, arbitration is also governed by statute – in the UK the Arbitration Act 1996. In arbitration, an arbitrator or arbitral tribunal of more than one single arbitrator issues an award which is both binding and final (subject to a certain limited amount of possible regulation by the courts) and may be enforced through the courts. For a substantive dispute, it is an alternative to litigation in the courts. If a party has made an arbitration agreement, it can normally prevent the other party from going to court.

Arbitration is not well suited to multi-party disputes. There is little statutory provision for dealing with related disputes under different contracts, and that type of situation is usually better catered for without the use of an arbitration agreement. Conversely, a party to a contract which does not wish to find itself embroiled in a multi-party action may prefer arbitration to the courts precisely because it is a way of avoiding multi-party disputes.

Confidentiality is a feature of arbitration, as opposed to court proceedings, which are generally public. This is normally cited as an advantage of arbitration and may be a favourable feature in long-term relationships.

Although confidentiality is a feature of arbitration as opposed to proceedings in open court, open to the public, it is not always understood that the confidentiality is not of an absolute nature. Exceptions to the rule of confidentiality have to be made where, for example, a company must disclose relevant material for auditing or tax purposes, or in other court proceedings. Also, arbitral proceedings and awards are to some extent open to regulation by the courts, so that an arbitrator's award may in some circumstances be the subject of a reported decision in court or at least proceedings in open court. Confidentiality applies to arbitration not by statute but by reason of an implied term developed by the courts in case law. As it is an implied obligation, it may be affected or removed by express terms of the parties' agreement.

Court proceedings

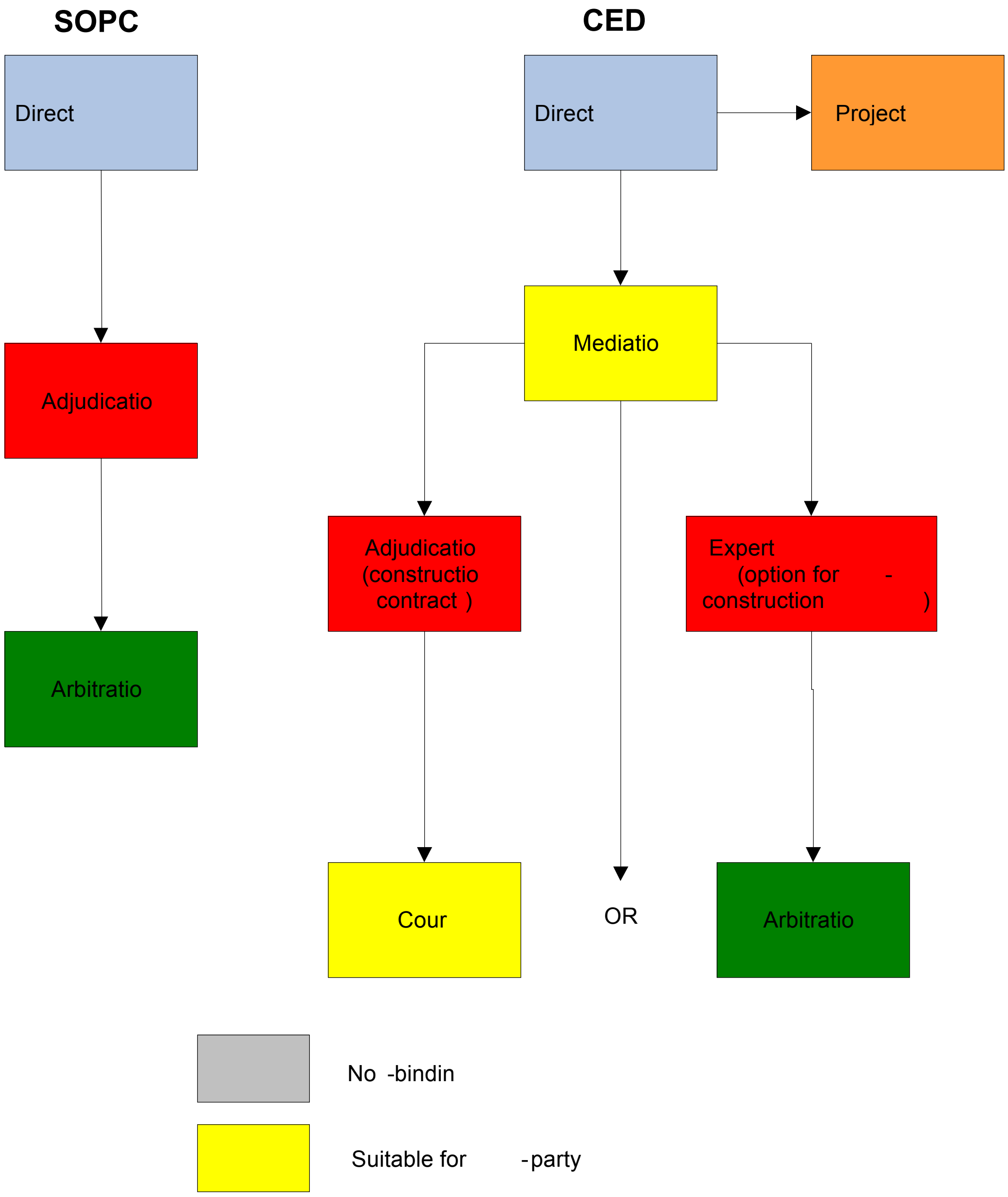
Obviously the least confidential of the possible proceedings, it is also an adversarial process and for those reasons it is not immediately attractive for PFI/PPP disputes. It is, however, suitable for multi-party disputes, as well as providing a high quality tribunal best suited to dealing with issues of law. Due to these positive aspects it is sometimes preferred to arbitration as the final resort dispute resolution tribunal for PFI/PPP disputes. As noted above, the M6 toll road has already provided no fewer than four High Court cases (as well as one Court of Appeal case). The High Court is also the appropriate tribunal for enforcement of adjudicators' decisions and for applications in relation to arbitral proceedings.

TYPICAL DISPUTE RESOLUTION PROVISION

Head Agreement

4Normally the head agreement will have a range of dispute management methods ranging from a starting point of amicable settlement via high level discussion, progressing to adjudication and ending with either arbitration or litigation in the courts. A convenient starting point is SOPC4 and the CEDR provisions are then also considered.

DISPUTE RESOLUTION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SOPC4

Direct Negotiation

The first level of dispute resolution is consultation “in good faith” between the Authority and the SPV (in this form referred to as “the Contractor”), “in an attempt to come to an agreement in relation to the disputed matter” within a fixed period (seven days is suggested in square brackets).

In view of the clear case law on this issue (see above), it is unlikely that anything other than a non-enforceable statement of intent was contemplated by the draftsman.

“Good faith” is a relatively unexplored concept in English contract law and would not be implied. An express obligation to do something in good faith will have its natural meaning, which is “honestly”. It could include an obligation to avoid making any misleading statements or concealing material facts. The inclusion here of a good faith obligation is curious, but as it is linked to an obligation to negotiate that is probably legally ineffective, it is of limited importance, its significance again being only in the context of an expression of intent to resolve disputes amicably.

Adjudication

The SOPC4 provisions largely reflect the mandatory provisions of section 108 of the HGCR Act, although, as noted above, the HGCR Act does not apply to the head agreement. SOPC4 therefore includes adjudication purely as a matter of contractual choice.

The HGCR Act provides a right, which cannot be altered by contractual provision in a construction contract to which the HGCR Act applies, to refer a dispute to adjudication at any time. SOPC4 does not follow the wording of the HGCR Act in the usual way, starting: “Without prejudice to paragraph (b) above [a reference to the provision discussed above concerning consultation], either party may give the other notice of intention to refer the dispute…”

The “without prejudice” wording is eccentric (the intent is somewhat unclear) and the absence of an express right to refer “at any time” as required by section 108 of the HGCR Act makes the provision of dubious validity when judged against the requirements of the HGCR Act. Whilst this does not matter where the adjudication provision is contractual only and not affected by the HGCR Act, there is a risk that the same provision would not be effective if it were stepped down into a construction sub-contract between the SPV and a sub-contractor. If this provision were stepped down, the Scheme provisions on adjudication would probably be incorporated into the construction contract in their entirety in place of the SOPC4 provision. Care will accordingly be needed when stepping down to make appropriate changes.

There is a further provision that is of doubtful effectiveness in terms of HGCR Act-compliance. The provision concerning the adjudicator’s decision links the time for the decision with the date of the adjudicator’s appointment, rather than the date of the referral of the dispute, as in section 108(2)(c) of the HGCR Act. Recent case law indicates this to be probably not HGCR Act-compliant.

SOPC4 deals with the appointment of adjudicators by providing for two panels of independent experts, one panel in respect of construction matters and one in respect of operational and maintenance matters.

There is provision relating to linked sub-contract disputes in relation to both adjudication and arbitration, discussed below under the heading “Arbitration”.

Arbitration

The final stage of dispute resolution under SOPC4 is arbitration, although a footnote suggests the parties may instead agree on litigation. The choice between these two approaches will involve weighing such factors as confidentiality, joinder of other parties, the quality of the tribunal and choice of tribunal. These matters are discussed further below.

The standard wording is on the basis of arbitration rather than litigation, which seems to reflect a general preference adopted, rightly or wrongly, in head agreements.

So far as appointment is concerned, SOPC4 leans towards appointment of a lawyer-arbitrator, providing for appointment by agreement of "a solicitor, barrister or arbitrator recognised by the Chartered Institute of Arbitrators" or in the absence of an agreed arbitrator, for appointment by the Law Society.

The arbitration clause continues with an unnecessary provision empowering the arbitrator to open up, review and revise certificates, a form of wording imported from UK construction contract draftsmanship that has been out of date for over ten years. This formulation of words was wrongly considered to be important, in that it was mistakenly thought to give an arbitrator the power to modify the parties' contractual arrangements, as the result of a Court of Appeal decision in the *Crouch* case in 1984. That decision, however, was overturned by the House of Lords in the *Beaufort* case in 1998 and "open up" wording is no longer required, although draftsmen today often persist in it. The correct position is that certificates, decisions and the like are either final and conclusive, in which case an arbitrator or the court will alike give effect to them accordingly, or, much more usually, an interim mechanism for determining the parties' rights and duties at any moment, which does not prevent either an arbitrator or a court, or other dispute resolution tribunal, from subsequently reaching a different decision on the parties' rights and duties according to the contractual provisions.

There is provision for the arbitrator's decision to be final, which removes the possibility of appeal on a question of law which would otherwise be available. This gives the parties finality and greater confidentiality, but it does also mean that it will be virtually impossible to correct even a plain and obvious error of law by an arbitrator.

The main feature of interest of the arbitration provisions, however, concerns the treatment of related issues arising under the head agreement and the SPV's sub-contracts. There may be a relationship between (1) a dispute arising between the Authority and the SPV (the Contractor under SOPC4) under the head agreement and (2) a dispute arising under the construction sub-contract or the operating sub-contract. In that event, the Contractor (the SPV) may include, as part of its submission to the arbitrator appointed for the dispute under the head agreement, submissions made by the construction sub-contractor or the operating sub-contractor. So far, so good. The provision continues:

> "The Adjudicator or the Arbitrator, as appropriate, shall not have jurisdiction to determine the Construction Sub-contract Dispute or the Operating Sub-contract Dispute but the decision of the Adjudicator or the Arbitrator shall, subject to Clause 27(I), be binding on the Contractor and the Construction Sub-contractor insofar as it determines the issues relating to the Construction Sub-contract Dispute and on the Contractor and the Operating Sub-contractor insofar as it determines the issues relating to the Operating Sub-contract Dispute."

This provision in the head agreement cannot on its own have the effect stated, since an agreement that a sub-contractor is to be bound by the decision of an adjudicator or arbitrator will only be effective if the sub-contractor is party to that agreement.

Since neither the Construction Sub-contractor nor the Operating Sub-contractor is a party to the head agreement, the provision concerning binding effect on them is of no effect. The need for a further separate agreement is recognised in the notes preceding the standard clause wording (sub-paragraph 28.3.2). The only real purpose of this provision, it would seem, is to provide some wording which will need to appear in the Construction Sub-contract and in the Operating Sub-contract, if the decisions referred to are to be effective in relation to the Construction Sub-contractor and the Operating Sub-contractor. The provision could be given some teeth by the addition of an obligation on the Contractor (the SPV) to include the provision in its sub-contracts.

Interesting questions may arise if such provisions are included in the sub-contracts and put into operation. While it is possible that such provisions will work as intended, provided they are framed in sufficiently clear words, they do still concern proceedings of a judicial nature in which the parties' rights and obligations are determined. If the determination of a Construction Sub-contractor's or an Operating Sub-contractor's rights and/or obligations takes place without the Construction Sub-contractor's or Operating Sub-contractor being present or being represented in the proceedings, then it is doubtful if the requirements of natural justice, including in particular the right to have one's case heard, would be met. The natural justice problem may be met if the Construction Sub-contractor or Operating Sub-contractor is given adequate opportunity to make submissions, even if not directly represented.

It should be noted that the SOPC4 provisions fall far short of providing for tripartite arbitration or joinder of related arbitrations, and therefore far short of what is available in court proceedings. This is quite deliberate, as the guidance notes state:

> "The Contractor and its Sub-contractor may require the right to join their disputes into a dispute under the Contract [the head agreement] if the same issues are involved. This should generally be resisted by the Authority as it will only increase the time and cost of the process for the Authority. The Authority should not automatically become embroiled in the Contractor's disputes with its Sub-contractors, particularly as the Contractor should in any case ensure that, as far as possible, decisions under the Contract flow down the contractual chain…"

Therefore, in this context, from the Authority's point of view, the absence in arbitration legislation of provision for joinder of arbitral proceedings other than by the consent of all the parties to separate arbitrations, analogous to the joinder available in court proceedings, is seen as an *advantage* of arbitration. The position is of course different, as is recognised in the guidance notes, from the point of view of the SPV or sub-contractors. The SPV in particular is at risk of inconsistent decisions in related disputes between different parties up and down the contractual chain. While that could work to the SPV's advantage, the risk that it will not is not one that an SPV is normally commercially well placed to take. Furthermore, in a worst case scenario, it is not one which is in the interests of the Authority to allow to develop, as it could lead to the insolvency of the SPV.

Mediation

One possible step in the array of available dispute resolution mechanisms, mediation, is not included in SOPC4, as noted above, although the guidance notes mention the possibility of substituting other forms of alternative dispute resolution (ADR) for adjudication. However, a footnote in the guidance notes to SOPC4 states that mediation will not be appropriate where there are project documents which are subject to the HGCR Act. That is merely a questionable opinion, however. Where statutory adjudication is available, that does not preclude also having the option of contractual mediation.

Below, the CEDR standard provisions for PFI projects, which do include a mediation provision, are also considered.

CEDR Dispute Resolution Procedure for PFI and Long-Term Contracts

The Centre for Effective Dispute Resolution (CEDR) is a commercial organisation which is a market leader in the provision of mediation services in the UK. It has been the subject of effusive judicial comment by Colman J in 2002 in the *Cable & Wireless v IBM* case: "…one of the best known and most experienced dispute resolution service providers in this country. It has over the last 12 years made a major contribution to the development of mediation services including mediation methodology and consultative services available to parties to disputes who need advice on both a choice of mediator and on appropriate procedures for mediation."

CEDR has produced model dispute resolution terms for PFI/PPP and long-term contracts. It is not thought that these terms are widely used, but they provide a comprehensive menu of dispute resolution methods, providing the following steps:

(1) negotiation by "Senior Executives", attempting in good faith to resolve the dispute. This is similar to the first stage in SOPC4 and is similarly non-enforceable;

(2) the parties may appoint a "Project Neutral" to advise and assist, but this person will not be appointed as a mediator, adjudicator, expert or arbitrator;

(3) the parties may agree to go to mediation. As noted above, an obligation to mediate in accordance with the CEDR mediation procedure is an enforceable obligation;

(4) in the case of a construction dispute or where the parties agree, adjudication. The provision is for adjudication unless the parties agree to refer the dispute to mediation. Under section 108(1) of the HGCR Act, a construction contract must enable a party to a construction contract to give notice *at any time* of his intention to refer a dispute under the contract to adjudication. That is to say, even if the parties have agreed to refer the dispute to mediation. It is doubtful if the CEDR provision is HGCR Act-compliant, which means that in the case of a construction contract to which the HGCR Act applies, the adjudication provisions of the statutory Scheme apply, not just the terms that appear in the CEDR terms. The CEDR document also has provision for adjudication for non-construction disputes, which does not run into the same difficulty. In these disputes, it is a form of expert determination, but it is not final except for disputes of an agreed low value (£50,000 is suggested in square brackets in the CEDR form);

(5) the CEDR form has provision for dealing with related disputes under different contracts. These provisions require only that the same adjudicator be appointed where the Provider (the CEDR term for the party designated here as the SPV) has related disputes raising substantially the same issues under both the head agreement and another contract with another or other parties.

Whichever contract yields the dispute first, the Provider may require the same adjudicator to be appointed for the related dispute under the other contract, unless the adjudicator has a conflict of interest;

(6) expert determination is an option. The determination is binding but not final (except for disputes of an agreed low value), with final determination by either the courts or in arbitration;

(7) finally, reference to the courts or arbitration.

In the case of arbitration, the parties may select procedural rules which can then be identified in an appendix. The standard CEDR provision is very short. The CEDR provisions do not, as they stand, do much to tackle the problem in arbitration of related disputes under different contracts. These matters are easily catered for in mediation or court proceedings, but require detailed provision and are difficult to cater for in adjudication or arbitral proceedings.

SPV SUB-CONTRACTS: EQUIVALENT PROJECT RELIEF (EPR) PROVISIONS

The purpose of EPR provisions is to provide the SPV with back-to-back obligations in its sub-contracts. These provisions include provision to the effect that payment will not be made by the SPV to its sub-contractors until after the SPV has received payment from the Authority. The amounts to be paid to sub-contractors by the SPV in respect of particular matters are also limited by the amounts received by the SPV. An example of an EPR provision in the *Midland Expressway* case is given below. Before turning to the EPR issues, it is necessary to provide some background on the law concerning "pay-when-paid" provisions, which is a related issue, as will become clear.

Definition of "pay when paid"

The expression "pay when paid" here refers to a contractual provision in a sub-contract, under which the SPV is obliged to pay the sub-contractor for work undertaken by the sub-contractor only when the SPV has itself received payment for the sub-contractor's work, from the Authority under the head contract. The same principle applies to any similar contractual chain. Section 113 of the HGCR Act (see below) provides a statutory definition of what is here referred to as "pay when paid".

As noted above, the HGCR Act applies to construction contracts, so that the HGCR Act provision concerning pay-when-paid clauses in a contract applies to construction sub-contracts but not to other sub-contracts. The HGCR Act is likely to apply to the construction phase of a PFI/PPP project and may also apply to the facilities management phase, depending on the nature of the facilities management and whether it consists of or includes construction operations, as defined in the HGCR Act. Construction operations include, for example, repair and maintenance of any works forming part of the land, but not, for example, routine cleaning of buildings or catering.

Some contracts are for a mixture of works, some of which are construction operations and some of which are not. In that event, the HGCR Act applies only to that part of the contract which relates to construction operations. Consideration could be given by the SPV to separate sub-contracts for these separately regulated activities.

Effect of pay when paid

Leaving aside the effect of the HGCR Act, the position in English law, it is suggested, is that a carefully and appropriately drafted pay-when-paid provision would be construed in the English courts as disentitling the sub-contractor from payment for all time if payment were not made by the Authority to the SPV.

The position has been simplified by the HGCR Act for cases to which it is applicable, that is, in cases concerning agreements for construction operations. A pay-when-paid provision will be effective in the event of the employer's insolvency, but not otherwise. Pay-when-paid provision is in cases other than the insolvency of the employer simply invalid.

A pay-when-paid provision is simply a matter of risk allocation, the risk being non-payment by the employer. Leaving PFI/PPP projects aside for a moment and simply considering ordinary construction projects, the argument apparently accepted by Parliament and enacted in the HGCR Act (except where the non-payment results from the employer's insolvency) is that this risk must always, as a matter of law, be taken solely by the main contractor and may not be passed on to sub-contractors. Put another way, on this principle the contractor must fund the project, including all the sub-contract work, in the event of non-payment by the employer, other than by reason of insolvency.

This is an argument that may have a certain appeal in a certain context, for example in the case of a small building project with a substantial main contractor engaging a number of small sub-contractors owning few assets. The commercial considerations applicable with PFI/PPP projects are, it is suggested, entirely different and are considered below.

The statutory provision

Under section 113(1) of the HGCR Act, a pay-when-paid provision is invalid, except where the non-payment by the employer is as the result of insolvency. Where a contractual provision (a pay-when-paid provision) is rendered ineffective by section 113(1), the parties are free to agree other terms for payment. If they fail to do so the relevant provisions of the Scheme for Construction Contracts apply. The Scheme sets out a payment regime which is not dependent on receipt of payment from a third party.

The relevant provision on pay-when-paid is section 113(1):

> "A provision making payment under a construction contract conditional on the payer receiving payment from a third person is ineffective, unless that third person, or any other person payment by whom is under the contract (directly or indirectly) a condition of payment by that third person, is insolvent."

Pay when paid and the *Durabella* case

In the *Durabella* case, the sub-contract terms included a pay-when-paid provision (clause 4) as follows:

> "Our liability for payment to you is limited to such amounts as we ourselves actually receive from the employer in respect of your works under this order."

Judge Lloyd considered the application of the common law to this provision. One applicable common law principle is that a party may not benefit from his own breach of contract. On the basis of this principle, a main contractor may not rely on a pay-when-paid provision to deprive a sub-contractor of payment, where the employer's non-payment is as a result of the main contractor's own breach under the main contract, to which the sub-contractor has not contributed. It would presumably be different if the main contractor were in breach under the main contract as a direct result of breach under the sub-contract by the sub-contractor.

Judge Lloyd's further statement of common law principle involved the addition of two implied terms. The first of these is that it is an implied condition for the operation of a pay-when-paid clause that the machinery of payment is capable of being operated. The second implied term is to the effect that the main contractor undertakes to pursue all means available to obtain payment.

Pay-when-certified

There has been some suggestion that a pay-when-certified provision, as opposed to a pay-when-paid provision, may also be invalid. Under a pay-when-certified provision in a sub-contract, the main contractor is obliged to pay the sub-contractor for work undertaken by the sub-contractor only when the main contractor has received certification for the sub-contractor's work, from the employer or the employer's certifying agent under the main contract, regardless of whether the main contractor has also received payment.

This type of provision has generally been considered to be valid both before and after the HGCR Act. For example, in various reviews and consultation papers considering the benefits of and the possible content of further HGCR Act-related legislative reform, discussion of the possibility of further legislation to render invalid pay-when-certified provision has proceeded on the basis that at present such provisions are valid.

The words "conditional on the payer receiving payment from a third person" in section 113(1) seem plain and clearly limited to receipt of money rather than extending to receipt of a certificate but not money. Therefore, it is suggested, a pay-when-certified provision remains valid post the HGCR Act. Further legislation which will have the effect of invalidating pay-when-certified provisions is now planned, however, although when it will be enacted is not yet known. The existence of this proposed legislation is a further indication that a pay-when-certified provision is currently valid.

The view that a pay-when-certified provision is valid under the HGCR Act was taken, correctly, it is suggested, in the *Durabella* case. Judge Lloyd stated:

> "…section 113(1) does not affect payment on conditional certificates. As provided by sections 109 and 110 (and 113(6)) of the Housing Grants, Construction and Regeneration Act, payment periods can be agreed which have the effect of ensuring that, where the main contract payment system is operating properly, payments to a sub-contractor need not be made until

> after the time when payment should have been received. The risk of having to finance work before payment is received is either averted or at the least minimised. The parties' freedom to make such arrangements is legitimate and not unreasonable."

The position is, however, somewhat uncertain in the light of some of the analysis in the *Midland Expressway (No 2)* case, discussed below. See also the discussion of the Local Democracy, Economic Develpoment and Construction Bill, below.

***Midland Expressway No 2*, Pay When Paid and Section 113**

Midland Expressway Ltd ("MEL") entered into a concession agreement with the Secretary of State for Transport to design, construct and operate the Birmingham Northern Relief Road, now known as the M6 toll road. MEL entered into a contract with CAMBBA (Carillion, Alfred McAlpine, Balfour Beatty and AMEC) for the design and construction of the road (the D&C Contract). There was a dispute of circa £10m concerning "tiger tails", a reference to road markings used at the "tie-ins" where old and new motorway met.

The D&C Contract included the following provision of importance in the case as it related to payment for changes in work scope, a central issue:

> "39.6.2 Subject only to Clause Seven (Contractor's Rights) and notwithstanding any other provisions of this contract, the contractor's rights to any price adjustment under or in connection with Clause 39 (Changes) in respect of a department's change shall in no event exceed the amounts, if any, to which the employer is entitled to be paid by the Secretary of State in respect to a corresponding change pursuant to Clauses 8.1.3.1 and 8.1.3.3 of the Concession Agreement."

Jackson J held sub-clause 39.6.2 ineffective by reason of section 113 of the HGCR Act. He considered that the practical effect of the provision was that CAMBBA would not be paid for the department's changes unless and until MEL had received a corresponding sum from the department. In so deciding, the judge treated the entitlement to be paid under the concession agreement as the same thing as MEL actually receiving payment under the concession agreement. It is questionable whether the judge's analysis is correct.

In linking the amount due to CAMBBA to MEL's entitlement under the concession agreement, sub-clause 39.6.2 is, it is suggested, akin to a pay-when-certified provision rather than a pay-when-paid provision. The better view, it is suggested and as stated in the *Durabella* case, is that section 113 legislates against pay-when-paid but not pay-when-certified provisions. (A full analysis and criticism of the judge's reasoning in *Midland Expressway* may be found in (2006) 22 Const. L.J. at 324: Peter Sheridan: *Pay When Paid, Pay When Certified and Section 113.*)

It is respectfully suggested that the judge's reasoning on sub-clause 39.6.2 is wrong. The judge took this possibility into account, stating:

> "If I am wrong…then I consider that clause 39.6.2 must be read in conjunction with clause 7.1.3. Save in those rare cases where the Employer certifies that it has funds available, clause 7.1.3 in conjunction with clause 39.6.2 constitute express and ineluctable "pay when paid" provisions."

As already stated, in the writers' view sub-clause 39.6.2 is not a pay-when-paid provision. The position with sub-clause 7.1.3 is different, as sub-clause 7.1.3(b) is a pay-when-provision, it is suggested. Sub-clause 7.1.3 is as follows:

> "Notwithstanding any other provision of this contract, in the case of a project relevant event, the contractor shall only be entitled to payment or recovery by any other means (including means of set-off or abatement) of any price adjustment to the extent that the following conditions precedent have, subject to clause 7.1.4, been satisfied. (a) An agreement has been made between the Secretary of State and the employer, or a determination has otherwise been made under or in connection with the concession agreement, establishing that the employer is entitled to equivalent project relief in respect of such price adjustment for such project relevant event, and (b) the employer has received the price adjustment funds or has certified that it has funds available to it for the purposes of payment of such price adjustment, provided always that if the employer has received or has available to it part only of the funds necessary for the payment of such price adjustment, the employer shall be obliged to make payment only to the extent of those funds available from time to time.`…

This provision was the EPR provision in the D&C Contract, which provided, at (b), for MEL to have received funds of equivalent amount before having to pay CAMBBA. EPR provisions are normal in construction sub-contracts for PFI/PPP projects but will be invalid by reason of section 113 where the HGCR Act applies.

The judge stated that there was clear pay-when-paid provision if sub-clause 39.6.2 were read with sub-clause 7.1.3. In the writers' view, sub-clause 39.6.2 is not a pay-when-paid provision, whether read with sub-clause 7.1.3 or not; sub-clause 7.1.3 is a pay-when-paid provision, whether read with sub-clause 39.6.2 or not. Therefore, in the writer's view, the judge was in error in finding that sub-clause 39.6.2 was invalid.

In the writer's view, sub-clause 39.6.2 should have been upheld as regulating the parties' agreement on the valuation of changes in work scope. However, the more general pay-when-paid provision at sub-clause 7.1.3 would (rightly) have been held to be invalid. This leaves SPVs with the general problem of invalid back-to-back payment provisions (EPR provisions) in sub-contracts for construction operations.

The judge also stated:

> "At first blush it may be surprising that the parties have used any contractual provisions which are ineffective under the 1996 Act. There is, however, an explanation for this which Mr Streatfield-James gave in the course of his submissions. The D&C contract is based on PFI/PPP contract forms. PFI/PPP contracts are outside the scope of the 1996 Act. Therefore PFI/PPP contract forms have not been drafted with a view to compliance with those provisions."

This point is not correct, since by "PFI/PPP contracts" the judge means the head contracts for PFI/PPP projects. The contract for construction work and the sub-contracts down the contractual chain from the concession agreement are not excluded from the application of the HGCR Act. So far as any pay-when-provisions or EPR provisions are concerned, these will not appear at all in the head contract, as there is obviously no higher contract in the contractual chain to which provisions of this nature would apply. They will accordingly only be encountered down the contractual chain (where the HGCR Act may well apply), with payment conditional on payment under the head agreement.

Reverting back to what the writer said earlier about the dubious policy reasons for the legislation, it is again in the context of EPR provisions for PFI/PPP projects highly questionable whether there is any good policy reason for not permitting pay-when-paid provisions. The concession company for PFI/PPP projects like the M6 toll road is normally an SPV with no assets to meet claims other than payments received from the ultimate employer. On this basis those undertaking the works are normally content to proceed on a pay-when-paid basis. There is usually no compelling commercial reason to reject such a payment regime, since the ultimate paying party is the government. (As indicated above, these arrangements, while invalid in law, may have given rise to little difficulty in practice where the construction company is a member of the SPV, whereas the *Midland Expressway* case illustrates the lack of reticence about disputes where that is not the position.)

There is no likelihood of imminent relevant change in the legislation to meet the problem that pay-when-paid provisions are not permitted in sub-contracts for construction operations in PFI/PPP projects. Indeed, on the contrary, as explained further below, the currently unsatisfactory state of the legislation looks likely to be worsened by new restrictions on pay-when-certified provisions. Further, despite the well-known issue that there are perfectly valid commercial reasons for a pay-when-paid regime for PFI/PPP sub-contracts, no reform of the currently flawed legislation in this regard is proposed as part of the changes currently passing through the legislative process. Some legislative reform would nevertheless, it is suggested, be sensible. One option would be to exclude all levels in the contractual chain for PFI/PPP projects from the operation of the HGCR Act rule against pay-when-paid provisions. Another would be for this exclusion to apply only at the level of the SPV's sub-contracts. A further possibility would be to provide for sub-contract payment disputes to be resolved promptly under the head agreement, where the same issue also arises under the head agreement. A statutory mechanism could be devised under which the sub-contractor had the right to require the SPV to bring the related dispute to adjudication promptly under the head agreement, with the result binding both the SPV and the sub-contractor. While such a mechanism in contractual form may well fail to be effective, in statutory form it would of course be valid.

Despite previous comment from the writer on the need for legislative reform, and similar comment from the City of London Law Society Construction Committee,[1] as stated above, the proposed legislative changes to the HGCR Act currently being considered by parliament do little more than tinker with the payment provisions and worsen the position in relation to pay-when-certified provisions. In the foreseeable future, parties to these projects and their lawyers will be seeking contractual solutions to the problem created by section 113, rather than altering their commercial arrangements, which are not in need of any change on any sound or coherent policy grounds, it is suggested.

The impact of the Local Democracy, Economic Development and Construction Bill

Legislative "reform" is now on the horizon in the form of the Local Democracy, Economic Development and Construction Bill ("the Bill"). Unfortunately, none of the suggestions for legislative reform above has been adopted (despite their earlier

[1] [refer to paper]

publication by the writer). Rather, the legislature has tackled a different perceived problem with regard to pay-when- certified provisions.

The Bill, which is currently subject to the report stage in the House of Lords, proposes to amend the HGCR Act so as to render pay-when-certified provisions invalid. The relevant section of the Bill is section 138(2) and, if passed, it will prohibit any drafting which makes payment under a sub-contract conditional on (1) the performance of obligations under another contract, or (2) a decision by any person as to whether obligations under another contract have been performed.

It is the wording envisaged in point (2) above that will invalidate pay-when- certified clauses. The well-known problem for PFI/PPP projects described above has, unaccountably, not been addressed.

Contractual solutions

With the law as it stands, whatever draftingis adopted, the creation of a contractual answer to the EPR problem is something of a futile attempt at squaring the circle. There is a clear and obvious difficulty in reconciling the SPV's business need to avoid exposure down the contractual chain to payments over and above those received from the Authority with the law against pay-when-paid provisions (and the impending law against pay-when-certified provisions (where construction contracts are concerned).

To date, the approaches taken have, perhaps unavoidably, been more in the nature of ignoring the problem than solving it. The conundrum is that, whatever weasel words may be devised, they are likely to be dismissed as "circumlocution" by judges such as Jackson J, if their purpose is, as it will be, to get round the rule against pay-when-paid provisions. The following approaches have the following attendant problems:

(1) making payment by the SPV conditional on receipt of payment by the SPV (as was provided by the EPR provision in the *Midland Expressway* case). This plainly contravenes section 113 of the HGCR Act;

(2) making payment by the SPV conditional on entitlement to payment on the part of the SPV (as was provided in the *Midland Expressway* case in respect of changes in the works). This was decided by Jackson J to be contrary to section 113 of the HGCR Act (albeit arguably wrongly, for the reasons given above) and would be prohibited in the future by clause 138(2) of the Bill;

(3) the SPV providing for a long period for actual payment under its sub-contracts, to allow the SPV time to secure payment first under the concession agreement. While this does not contravene the HGCR Act, it entails the following problems: (a) it will for cash flow reasons be difficult to negotiate with sub-contractors; (b) if negotiable, it will add further financing charges into the pricing structure of the project; (c) however much time the SPV has, it ultimately retains the risk that it may not secure sufficient funds from the Authority to meet its liability to sub-contractors;

(4) a loan provision, under which whatever the sum to which a sub-contractor is entitled over and above what is received by the SPV from the Authority is immediately lent to the SPV by the sub-contractor, interest-free. A loan ultimately has to be repaid, so that the SPV does not ultimately solve the

potential problem of inconsistent liability up and down the contractual chain, or, if the terms of the loan agreement are that the repayment is in whatever sum has in due course been determined under the head agreement, then the so-called "parallel loan" appears not really to be a loan but an invalid pay-when-paid provision which has been called a loan. A more sophisticated variant of the "parallel loan" is an arrangement under which the sub-contractor's parent company provides a the "parallel loan" to the SPV pending determination of the sum under the head agreement. The sum ultimately paid to the sub-contractor then matches the sum paid under the head agreement, with any shortfall borne by the parent company of the sub-contractor. The main advantage of this variant is that the relevant contract (between the SPV and the parent company) is a contract of guarantee, not a construction contract, so it is not caught by the unfortunate HGCR Act rules against pay-when-paid provisions. Care will be needed as to how to set up such a guarantee; an obligation in the sub-contract to provide such a guarantee could itself be of doubtful validity, as it could be construed as being in effect a pay-when-paid mechanism. A separate arrangement with the parent company would seem more prudent. A potential practical difficulty is that the parent company will not be willing to enter into such an arrangement;

(5) a name-borrowing procedure under which sub-contractors are entitled and obliged to bring claims, which raise the same issue under the head agreement, in an adjudication conducted by the sub-contractor in the name of the SPV against the Authority, with both the SPV and the sub-contractor bound by the result. A potential legal difficulty is that a contractual requirement of this type could contravene the sub-contractor's statutory right to bring an adjudication against the SPV at any time. However, given good relationships, sub-contractors may generally be content with the contractual mechanism rather than the statutory right. There are other non-legal potential difficulties for the SPV in terms of concerning the management of the relationship with the Authority and control of a process brought in its name by another entity.

As a matter of practicality, as opposed to contractual provision, the problem for the SPV is likely to arise in connection with changes or varied work rather than normal contracted-for construction work. The latter is not relevant to EPR, since the SPV bears the construction costs normally anyway, later recouping its position from the Unitary Charge. There are practical steps the SPV may take to manage and minimise the risk of a mismatch between money received and money paid. For example, it may require pre-pricing and seek pre-agreement of pricing for varied work in its construction sub-contract and then seek a similar process under the project agreement; it may seek a budget from the Authority for varied work and issue instructions under the construction sub-contract limiting the amount to be expended or incurred so as to stay within budget.

SUB-CONTRACTS: CONSULTANTS

As with the contractor for the construction works, the SPV may enter into appointments with consultants, such as architects and engineers, for design and other consultancy work at the construction stage. Unlike the contractor, who may well be part of the SPV, these consultants will not generally also be members of the SPV.

Because of the size of the projects and their long-term nature, these appointments are potentially of high interest and value to the consultants. From the SPV's point of view, with its focus on the long-term operation of the project, these appointments and the performance of them are also of critical importance. The SPV's task, as with the other sub-contracts referred to above, will be to seek to pass down back-to-back obligations which mirror the SPV's own design and consultancy obligations under the head agreement.

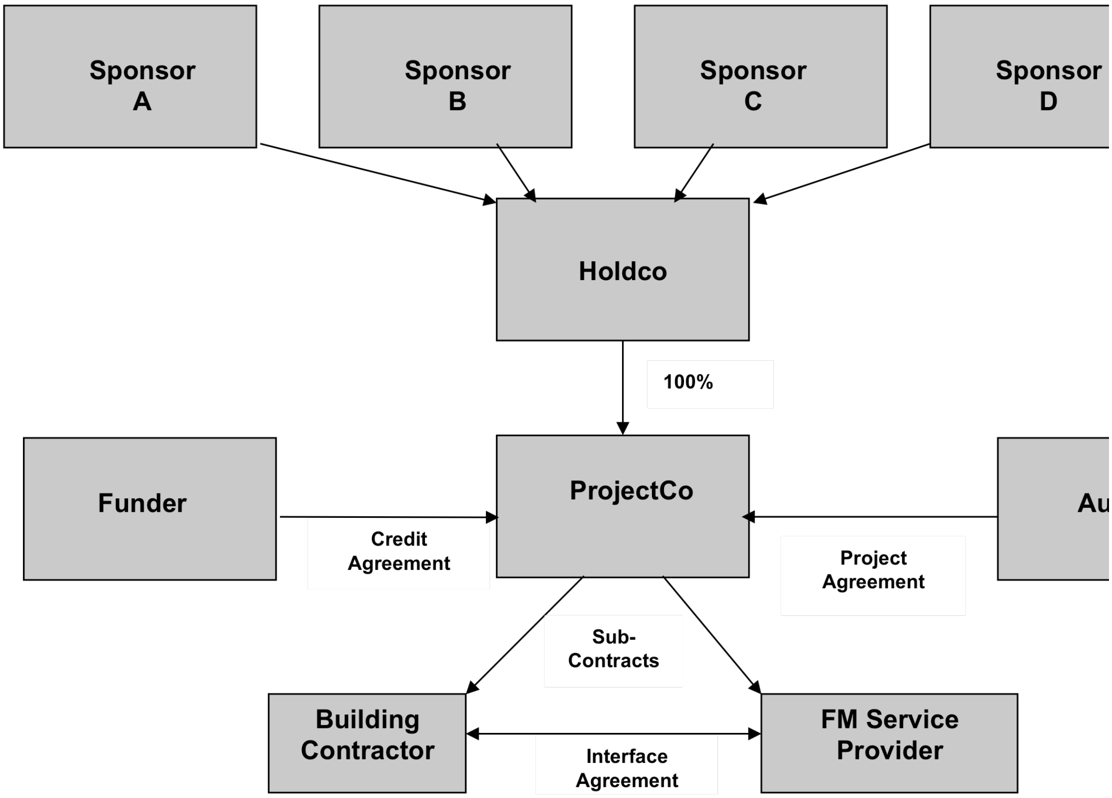
Perhaps because of the informal way in which design consultants traditionally negotiate their terms of appointment, one does see even these multi-million pound appointments drifting through various exchanges of correspondence without the production of a crisp formal appointment.

One area of dispute that, in the writer's experience, may be likely to arise in this situation in relation to PFI/PPP projects, such as health and education where there is likely to be a stream of work over, say, a 30-year period, is in connection with the prospect of future work. Discussions are likely to take place between the SPV and consultants relating to this highly attractive potential for long-term work. These discussions may, in the absence of clear and certain contractual documents, be regarded by the SPV as merely non-binding talk about future possibilities but by the consultant as some form of commitment. It is important from the point of view of both parties to enter into clear contractual arrangements at an early stage, which may of course be superseded by later similar arrangements as opportunities develop.

These types of appointment are normally covered by the HGCR Act, so that adjudication will be available for dispute resolution, whether this is expressly stated in the appointment made or not. The SPV should give consideration to the dispute resolution provisions generally, as multi-party issues may well arise at the construction phase where issues of quality, for example, may relate to design, workmanship or a combination of the two. How disputes of this type may be managed will depend on consistent arrangements in the SPV's various sub-contracts.

Another quite usual course for the SPV is to sub-contract all of the design work as well as the construction work to the contractor. In that event, the contractor is likely to engage sub-consultants and the same issues as described above will potentially arise at the sub-consultancy appointment level of the contractual chain.

POTENTIAL CONFLICT OF INTERESTS FOR DIRECTORS OF THE SPV AND ANOTHER PROJECT PARTNER


Sponsor A
Sponsor B
Sponsor C
Sponsor D
Holdco
100%
Funder
Credit Agreement
ProjectCo
Au
Project Agreement
Sub-Contracts
Building Contractor
FM Service Provider
Interface Agreement

The diagram above illustrates the usual corporate/contractual structure for a PFI/PPP project. The project partners("Sponsors"), such as the building contractor, funder and the FM provider, set up a holding company ("Holdco"), of which they are the Shareholders. The "Holdco" owns the entire issued share capital of the SPV or "ProjectCo". In some circumstances, there is no requirement for Holdco, and the Sponsors simply own shares in the SPV.

Where the directors of Holdco or the SPV are also directors of the project partners, there is a significant risk that conflicts of interest may arise.

The Companies Act 2006, which codifies the long standing common law duties of directors, provides that a director of a company has seven general duties, namely

- A duty to act within his or her powers;
- A duty to promote the success of the company of which he or she is a director;
- A duty to exercise independent judgment;
- A duty to exercise reasonably care, skill and diligence;
- A duty to avoid conflicts of interest;
- A duty not to accept benefits from third parties; and
- A duty to declare any interest in a proposed transaction or arrangement.

It is self-evident that what may be in the interests of the SPV may conflict with the interests of companies seeking payment from it, such as the Building Contractor or FM provider.

Where a conflict of interest is likely to arise or has arisen, the director who is or may be conflicted must seek authorisation from the other directors in order to exercise his powers as a director.

In relation to PFI/PPP projects, conflicts of interest are most likely to arise in relation to a director of the SPV and another project partner who seeks to act in the best interest of the project partner rather than the SPV.

The duty to promote the success of the company for the benefit of its members as a whole has been interpreted to include promoting the success of the company for the benefit of its stakeholders. A stakeholder is someone other than a shareholder who has an indirect interest in what the company may be doing. For example, this may include suppliers, customers and other companies with which the company may have a business relationship. Accordingly, in order to ensure the long term success of the company, directors must have regard to what the Department for Business Enterprise & Regulatory Reform refers to in its commentary on the Companies Act 2006, as "responsible business behavior". In the context of PFI/PPP projects it is conceivable that this may extend to considering the needs of a company's partners in a PFI/PPP Project to ensure the long term success of the company.

Accordingly, it is advisable where possible that different directors should be appointed at SPV and project partner level.

Where an aggrieved shareholder believes that a director of the SPV is not acting in the best interests of the SPV and wishes to make a claim against the director for breach of a director's duty, it may use the provisions of the Companies Act 2006 to commence a derivative action. Importantly, the Companies Act 2006 has removed the longstanding requirement that, in order for a shareholder to commence a derivative action a shareholder must show that the director benefitted personally from the breach. Accordingly, derivative actions are now easier to commence.

INTERFACE AGREEMENT

An "interface agreement" means a contract between the SPV, the contractor and the FM provider. It may also mean a bipartite contract between the contractor and the FM provider only, but a tripartite agreement is normal.

Without this additional contract, there would be no contractual link between the contractor and the FM provider, who will each have a sub-contract with the SPV. There is no absolute necessity for an interface agreement, but without one the SPV is left with the role of resolving disputes and issues of responsibility as between the contractor and the FM provider, just as a main contractor has such a role in relation to its sub-contractors in the context of a conventionally procured construction project. Similarly, the contractor and FM provider would have no remedies against one another, so that any complaint or claim that one had relating to the other would have to be pursued as a claim against the SPV, who would then have the option (and the problem) of pursuing the matter against one of its other sub-contractors.

While "interface agreement" will have the meaning given above for the purposes of this discussion, "interface" issues also arise in other ways. For example, there is an "interface" between the contractor and the specialist information technology (IT) contractor, whose requirements have to be accommodated in a building. While, as stated above, it has understandably been decided that PFI/PPP is not suitable for IT projects *per se*, there is inevitably an IT element in modern buildings procured through PFI/PPP, notably as a highly important and, in monetary value, significant element in schools but also to an extent in hospitals or court buildings.

From the SPV's point of view, it may not want or may not have within it the necessary expertise to undertake the task of managing "interface" disputes effectively. It may accordingly be preferable to have an interface agreement under which problems as between contractor and FM provider are resolved by them. This is not necessarily the best policy, however; the SPV may find that difficulties are best minimized by its own early involvement when problems arise, and that it is worthwhile investing in the necessary expertise at SPV level to have the capability to resolve issues quickly and effectively.

The SPV should, in addition to the policy issue discussed above, also consider whether the interface agreement alters the risks taken by the SPV or reduces them. The SPV should be clear as to what residual risk it bears. Similar considerations apply to the other parties to the interface agreement; the sub-contractors will, for example, want to ensure that any monetary cap on liability to the SPV is not increased in aggregate by the acquisition of liability under an interface agreement.

The primary purpose of an interface agreement, as stated above, is to provide privity of contract as between the contractor and the FM provider. Standard content is likely to include an undertaking from each to the other to perform the obligations it already has to the SPV. A co-operation obligation is usually included and there may be provision as to the consequences of any disruption which either party may encounter during an period of overlap of the parties' presence on site.

There is potential for the contractor to fall behind in the delivery of the project and the FM provider may suffer loss as a result. The usual remedy in the interface agreement is a claim for liquidated damages. The contractor will want to ensure that there are some reasonable defences to such a claim, for example where the delay has arisen because of some act of prevention on the part of the Authority.

Building defects have obvious potential for disputes between contractor and FM provider. Once the contractor has left site, it may be appropriate for minor defects to be dealt with by the FM provider (for payment). During the maintenance period, the contractor will normally return to remedy defects for no additional payment, but at this time there is potential for the contractor and FM provider to disrupt one another. As more time passes, there is increased scope for argument as to whether defects are workmanship or maintenance issues. Defects after the normal limitation period for these projects (12 years) are normally an SPV risk, not normally insured.

An aspect of the "interface" between the contractor and the FM provider is that the FM provider often provides a schedule of requirements it has for the purposes of facilities management, which are relevant to the construction process. There is potential for the FM provider to delay the contractor by not providing information in time. There is also some potential conflict of interest between the parties in this regard. The contractor's interest is in minimising construction costs, the FM provider's interest, which is in minimising the maintenance costs, may be better served by higher construction costs.

BID COSTS

The extent of costs which are incurred by the private sector in the run-up to the award of public sector contracts remains a key issue for those involved in the PFI/PPP market. Although the process of standardisation has done something to reduce the costs incurred by those involved in public contracts competitions, the truth is that it remains fairly commonplace to incur millions of pounds of abortive fees in chasing contracts of this type. The extent to which the level of bid costs acts as a deterrent to potential new entrants to the PFI/PPP market is difficult to quantify. There is a strong argument that the level of bid costs precludes the public from attaining value for money because it is a real disincentive to compete.

The very significant costs incurred by participants in the competitions for the award of public contracts throw into sharp relief the consequence of cancellation by the public sector of such projects. There is no prohibition on the authority terminating an award procedure under the procurement rules although in giving consideration to whether to cancel a project an authority must exercise its discretion to do so in the same way as any other discretion is exercised by it.

The bid costs of a party which has reached the preferred bidder stage (stage 12 of a typical 13-stage process which ends with financial close and the award of the contract) were illustrated in 2006 by the example of the Colchester General Hospital PFI/PPP project. It is reported that AMEC was preferred bidder for 18 months, during which it produced a complete design at a cost of circa £7m. However, at that stage, the Authority (Essex Rivers Healthcare NHS Trust) cancelled the project, apparently not because of any problem with AMEC but because the project was then considered too expensive.

It is of course not possible to analyse the legal issues without access to all the relevant information, but one can speculate that in these circumstances it is unlikely that AMEC would have any solidly founded legal remedy, since it is likely that it was made clear that there was no commitment to the project until the last stage was reached.

The stark example of the Colchester General Hospital of the long period at preferred bidder stage and the very late cancellation of the project indicate a possible need in the future for some financial safeguards for a preferred bidder to recover costs in similar circumstances, particularly where a project is cancelled for reasons which are outside the normal risk area for the preferred bidder. That is, a preferred bidder would probably expect no compensation if terms simply could not be agreed, but if the project were cancelled for reasons unconnected with the preferred bidder, it would seek at least costs recovery. It may well accept the risk of not recovering loss of profit in these circumstances as part of the risk of being a participant in the PFI/PPP market, but not such substantial out-of-pocket expenditure.

As long ago as 1997, the first of the Bates reviews recommended that “when a decision is made not to proceed with a project and that decision is not related to the viability of tenders received, contractors’ bidding costs should be refunded.” As yet this recommendation has not been implemented by the UK Government. It may be that the commitment letters which are normally signed to cover the period from preferred bidder to financial close will be developed to cover the circumstances in which some of the contractor's costs may be refunded.

The 2005 report by the RICS on *Quantifying Quality* recommended that a proportion of unsuccessful or abortive tendering costs for short-listed bidders should be repaid. That report indicated that the risk capital involved in preparing PFI/PPP bids was demonstrably higher than was the case in other forms of procurement. This, together with the protracted timetable allows only the very strongest companies to make this initial investment. Not surprisingly against that background, there is now significant market pressure for the reimbursement of bid costs and further developments may be expected.

It is understood, for example, that the Department of Health has commissioned its advisers to develop a compensation regime to deal with the downscaling and cancellation of health PFI/PPP projects. Approval will then be sought from HMT with payments to be routed through the health trusts. This scheme will deal with costs post preferred bidder stage; pre-preferred bidder costs will remain a private sector risk. Armoured Vehicle Training Services (AVTS) and Lorry Road User Charging both had cancellation and bid cost replacements in part.

The issue of bid costs was most recently raised in the courts in the *Aquatron Marine (t/a Quatron Breathing Air Systems) v Strathclyde Fire Board* case. This was a Scottish Court or Session case and was the first case in eight years in the UK where a court awarded damages for breach of EU public procurement rules.

Aquatron bid to provide maintenance and repair services for breathing apparatus supplied to the Strathclyde Fire Board. The Authority accepted a tender which did not conform with the specification published in the notice in the Official Journal. Accordingly, Aquatron claimed that the Authority failed to treat all bidders fairly.

In this case the court held that the Authority made several mistakes during the award procedure. The Authority's decision to exclude Aquatron and reject its bid on the grounds that its quality certification was not permissible under the procurement regulations was a breach of the procurement regulations. On the facts, the court decided that Aquatron's bid should have won and awarded it compensation for loss of profits.

Aquatron's damages amounted to the sum of the bid, less the estimated cost of carrying out the contract, plus interest. Although Aquatron's bid costs themselves were not recoverable as they would have been incurred (and not recovered) if the bid had been successful, the case at least gives guidance and demonstrates a willingness of the courts to compensate where there has been a breach of the procurement regulations.

PROCUREMENT ISSUES

Challenging the award of PFI contracts in the United Kingdom

For many years, in contrast to some parts of the globe (the United States and other parts of Europe being prime examples) there has been relatively little evidence of a significant incidence of challenges to the award of contracts in the UK. Although in the immediate years following the well-publicised cases of *Harmon CFEM Facades (UK) Limited v Corporate Official of the House of Commons* and *Severn Trent Plc v Welsh Water Limited*, there were signs of a changing climate with regard to public procurement matters, the spate of challenges which many were predicting failed to materialise. There are now, however, concrete signs that this reluctance has shifted, possibly due to changes in the economic climate. In the last three years or so there has been a 70% increase in procurement cases taken to court. Cases have been brought not only in England and Wales, but also Scotland and in Northern Ireland, where the courts have been particularly active.

The complexity of PFI/PPP contracts has meant it has been difficult to “fit” the public sector and utility directives (2004/18 and 2004/17, collectively “the Directives”), not specifically designed for PFI/PPP projects, and their UK implementing measures (Public Sector Contracts Regulations 2006 and Utilities Contracts Regulations 2006) (“the Regulations”) into the practice of PFI/PPP procurements.   A new legislative framework was introduced by the EU Commission in 2000, largely to consolidate the inconsistencies between the legislation dealing separately with contracts for works, supplies and services (Directives 93/37, 93/30 and 92/30 respectively) and, indeed, to consolidate these directives in any event. In place of the three directives which previously governed the award of public sector contracts, Directive 2014/18 was introduced following detailed and lengthy consultation by the European Commission. The directive governing the utilities sector has also been updated so that 93/38 has been replaced by Directive 2004/17. The amendments to the Directives were intended to “*simplify, modernise and radically improve the functioning of the public procurement markets*.” There is, on analysis,very little that is radical about the changes that were made to the procurement rules (see *The Law of Public and Utilities Procurement*, Professor Sue Arrowsmith 2nd edition, Sweet and Maxwell 2005 for a detailed discussion of the revisions). Many commentators consider this legislation to be a missed opportunity, in that it cannot be viewed as a significant improvement on the pre-reform position It may be the case the market will prove to be more significantly affected by the Public Contracts (Amendment) Regulations 2009, which implement the remedies Directive 2007/66/EC and came into force on 20 December 2009.

The PFI/PPP industry in the UK lobbied heavily for more flexibility in the award process and PFI/PPP-friendly procedures to be put in place. While greater flexibility has been introduced, much of it does not concern the award of PFI/PPP contracts. By way of example, considerable effort was expended in relation to crafting processes and procedures which would accommodate so-called “*eProcurement*”. The Directives contain provisions which allow the use of electronic communication and, indeed, reduce the minimum time limits where electronic communication has been used. Electronic auctions are now expressly accommodated, although, from the perspective of the PFI industry, it is difficult to see this as a great leap forward.

Problems with the Use of the Negotiated Procedure

One of the central questions set at the beginning of each procurement is “which award procedure should be used?” Utilities have much greater flexibility than the public sector in their choice of procedure and, therefore, ordinarily follow the more adaptable negotiated procedure. Save for very limited circumstances, contracts awarded in the public sector should follow the open or restricted procedures. The more flexible and therefore clearly more desirable negotiated procedure is not available automatically. In contrast to the open and restricted procedures, the great advantage of the negotiated procedure is that it affords the parties the opportunity to proceed together without first having developed a clearly defined scope of work – the work can then be developed in any way - which is not accommodated by the open and restricted procedures.

Very close consideration of the availability of the negotiated procedure has been given at Community level, following on from a Technical Note published by the then Treasury Taskforce: "*How to follow EC procurement procedure and advertise in the OJEC*". That guidance stated that "*PFI/PPP requires scope for tenders to offer innovative ideas for technical solutions and the allocation of risk*". In most cases, the guidance suggested, the competitive form of the negotiated procedure is best suited, although it was very careful not to purport to offer definitive legal advice on when the negotiated procedure can be used. Whether or not that was the case, the use of the negotiated procedure for a PFI Schools project in Pimlico, London resulted in the EU Commission initiating legal proceedings against the UK government. Although the matter was settled before reaching the European Court of Justice, this highlighted the danger of over-relying on the negotiated procedure, which was intended to be used only in exceptional circumstances.

In a communication of 1998, the Commission undertook to amend the then current directives with a view to allowing a more flexible dialogue. In the event, the proposals for the coordination of procedures for the award of public supply, service and works contracts departed from the Commission's original suggestions. The long-awaited modernisation of the procurement rules, implemented in English law in 2006, produced a new procedure – "*the competitive dialogue*" which, it was intended, would be used in place of the negotiated procedure. In essence, this new procedure has been introduced so as to afford greater flexibility in the award of complex contracts such as PFI/PPP contracts.

Competitive dialogue is broadly available in circumstances where the technical and financial legal aspects of a project have not properly been defined. It is clear that there is substantial overlap here between the circumstances in which the negotiated procedure and competitive dialogue may be used. Professor Sue Arrowsmith states that "*there are doubts over [competitive dialogue's] suitability for the very complex PFI projects and other PPPs for which it was mainly conceived. …There is some uncertainty over whether there is sufficient scope for flexibility in working with the "preferred bidder" after the final tender stage … even for relatively standardised PFI/PPP projects*."

Clearly, competitive dialogue is not the full mandate to negotiate for which some in the PFI/PPP industry had hoped. One of the first procurements to make use of competitive dialogue was the Olympic Delivery Authority's ("ODA") award of the delivery partner contract. The process for the award of that contract to the CLM consortium of Laing O' Rourke,CH2M Hill and Mace, involved a staggering 15 key stages.

The ODA 15 stages:

Stage 1	**advertise in the OJEU**
Stage 2	**receive requests for information**
Stage 3	**issue pre-participation questionnaire**
Stage 4	**requests to participate received**

Stage 5	**evaluate requests to participate and shortlist**
Stage 6	**debrief unsuccessful participants**
Stage 7	**invitations to participate to short list**
Stage 8	**competitive dialogue**
Stage 9	**invitations to tender**
Stage 10	**team simulation exercises**
Stage 11	**clarification meetings**
Stage 12	**tenders received**
Stage 13	**oral presentation**
Stage 14	**tender clarification meetings**
Stage 15	**tender evaluation**

No draft contract was issued at the start of the process. The contract drafting was carried out in the midst of the dialogue itself.

It is important to recognise that this particular process was one created by the ODA. There is nothing in the directives detailing how the process is intended to operate. The Office of Government Commerce (OGC) has produced guidance on the use of competitive dialogue which is available at the OGC website on www.ogc.gov.uk.

One likely consequence of the introduction of the competitive dialogue is that the ECJ will adopt a stricter interpretation towards the circumstances in which the negotiated procedure may lawfully be used.

The Effect of the *Alcatel* judgment

The facts of the case *Alcatel Austria AG and others v Bundesministerium fur Wissenschaft und Verkehr C* 81/98 were not remarkable. They involved the Austrian equivalent of the Department of Transport and an invitation to tender for the supply and installation of hard and software components for a data transmission system on Austrian motorways.

Under Austrian law, the contract between the successful tenderer and the contracting authority comes into effect when the letter notifying the tenderer of its acceptance is received. Accordingly, up to the date of receipt of the letter, interim measures may be adopted and unlawful decisions set aside. Beyond that date, the court has no power to set the contract aside and may only award damages.

The ECJ considered the extent to which member states were required to ensure that all decisions of contracting authorities were, in all cases, subject to review so as to afford disgruntled bidders a chance to seek to have the contract set aside notwithstanding the availability of damages. It was the ECJ's view that member states were indeed required to ensure that a contracting authority's award of a decision was subject to review.

The "standstill" obligation has now been codified in Directive 2007/66/EC and implemented in England, Wales and Northern Ireland by the Public Contracts (Amendment) Regulations 2009, as mentioned above.

Bid Costs

One area of particular interest in the context of competitive dialogue is the extent to which post-tender negotiations are to be conducted and, in this regard, the effect competitive dialogue will have on the significant problem bid costs (discussed above) pose the industry. Many argue that, rather than assist in the reduction of bid costs competitive dialogue will, in fact, ensure a greater need for early lender due diligence, hence racking up additional potentially abortive fees. Although the procurement directives include a new provision allowing authorities to pay bid costs of tenderers, this has not been widely used in practice.

Who may challenge award decisions?

A breach may be acted on by any contractor, supplier or service provider who in consequence of the breach suffers loss or damage. A contractor, supplier or service provider is someone who either sought, seeks to be or who might have wished to be a person to whom a works, supplies or service contract was awarded. Four main types of remedy are provided for in the regulations. These are interim injunctions, setting aside the contract, damages and contract ineffectiveness (introduced by the Public Contracts (Amendment) Regulations 2009). Aggrieved employees may seek to lobby the Commission to have proceedings commenced at Community level but these individuals have no standing before the national courts under the Regulations. Many are dissuaded from making complaints to the Commission, as it can take a number of years to see a complaint adjudicated by the European Court of Justice, by which time the contract will have been concluded and performed, either entirely or partially.

Procedural requirements

Claimants are required to inform the contracting authority of the nature of the alleged breach and that they intend to commence proceedings. This is a strict requirement and failure to adhere to it will render any action inadmissible.

The Regulations require that proceedings be brought promptly and, in any event, within three months from the date when the grounds for commencing the action first arose save where the court believes that there is good reason for allowing an extension to this period (r47(7)(b)). Historically, domestic courts considered a claim could be rejected as insufficiently prompt even if it was brought within the three month period (e.g. *Jobsin Co UK plc v Department of Health* [2001]. In January 2010, however, the ECJ ruled on a referral from the High Court that regulation 47(7)(b) did not effectively transpose Directive (89/665) in this respect, as a discretionary limitation period was not predictable in its effects. The national courts must now either use the discretion afforded by the legislation to extend the limitation period to the equivalent of three months from the date on which the claimant knew or ought to have known of the infringement of the public procurement rules or otherwise not apply the Regulations.

Special time limits apply for seeking a declaration of ineffectiveness (discussed below). If an award notice has been published in the OJEU or the contracting authority has informed the economic operator of the award, proceedings must be started within a thirty day period, beginning on the day after publication or notification. In other cases, the time limit is six months beginning the day after the date on which the contract was entered into.

Overlap with Judicial Review?

The remedies set out within the Regulations are expressly provided to be "*without prejudice to any other powers of the courts*". Seemingly, therefore, tenderers are able to seek to challenge public sector procurement decisions by way of judicial review. In order to do so the claimant would need to establish that the decision made had a sufficient public law element so as to give rise to judicial review proceedings. The disgruntled party must have a "*sufficient interest*" in the matter. The central question is, therefore, what amounts to a sufficient interest?

The UK courts gave consideration to the availability of judicial review in *Hibbert & Sanders* [1992] COD. The court held, in that case, that judicial review was not available principally because the decision in question was not a matter of public law but was one that sat entirely within the realm of private law. The court considered that there must be a specific element of public law to ensure that the decision could be challenged in this way following the decision in *R v East Berkshire Health Authority ex parte Walsh* [1985] 1 QB 152. The courts concluded that simply because the Regulations impose obligations on a public body, that does not in itself mean that judicial review would be available. That will only be the case where the courts can find some special "*public law interest*" to justify a judicial review. A different approach was taken in the Northern Irish case of *Leonard Personnel Limited* [2008] NIQB 63 where the Northern Irish High Court accepted that the fact the regulations impose a duty on public authorities to act objectively, fairly and transparently may give rise to the requisite public law interest.

It will be interesting to see if the courts adopt the position taken in *Leonard Personnel*. Professor Sue Arrowsmith has been critical of the decision in *Hibbert & Sanders*. Her view is that the UK courts have been inconsistent in their approach. She suggests that the better approach would be that, in principle, contracting powers are subject to public law principles of judicial review in exactly the same way as all other powers of government.

The CPR pre-action protocol for judicial review states that where an alternative procedure is available which has not been used, the court has a discretion to refuse leave for judicial review. The judge's decision as to whether or not leave should be given would depend upon the circumstances of the case in hand, which would include consideration of the nature of the alternative remedy available.

Non-financial Remedies

Specific provision is made in the Regulations for an injunction to suspend the award procedure or suspend the implementation of any decision and also for an order which would set aside a decision made by a contracting authority. This is discussed above in the context of the *Alcatel* judgment. One important exception to the prohibition of setting aside a contract which has already been awarded may exist in circumstances where there might have been some bad faith or collusion between the contracting authority and the contractor, so as to breach the procurement laws.

Ineffectiveness, the fourth and latest remedy, is a declaration by the court that the contract is to be considered ineffective from the time the declaration is made. This declaration is prospective and not retrospective. There are three grounds for ineffectiveness; in summary, these are where (i) the contract was awarded without the publication of an OJEU notice where this was required, (ii) a breach of the standstill or suspension rules has affected the economic operator's chances of obtaining the contract and prevented proceedings from being started before the award of the contract and (iii) particular breaches of the rules on mini-competitions under framework agreements and dynamic purchasing systems have occurred. If the court makes a declaration of ineffectiveness, it must also order the contracting authority pay a penalty. In respect of the other parties to the ineffective contract, the court may order compensation to be paid.

If the court is satisfied that any of the grounds for ineffectiveness apply but does not make a declaration of ineffectiveness for overriding reasons or (in any proceedings) is satisfied the contract was entered into in breach of the rules on standstill or suspension, it must shorten the length of the contract and/or order a penalty.

Damages

The Regulations do not set out in any detail the basis upon which damages for breach of the procurement rules could be quantified. Case law suggests that there are two main heads of potential loss. These are loss of tender costs and loss of profit. As stated above, the Court's approach in *Aquatron* was that as a successful tender re-coups its bid costs as part of profits made in performing the contract, the correct approach was to allow a claim for loss of the claimant's profits on the contract.

English courts will take into account the *probability* that, but for the breach, the entity claiming damages would have succeeded in being awarded the contract. The courts will look at what profit the claimant might have made from the contract had it been successful and then will assess the claimant's chances of being awarded the contract in question. By way of example, the court might decide there was a 60 per cent chance the claimant would have been awarded the contract and therefore award 60 per cent of the calculated profit as damages. The aim of the court is to reduce the value of the benefit which has not been received or the full cost of the risk incurred in a manner proportionate to the degree of likelihood that the benefit or risk would have been gained or indeed avoided. (Additional judicial guidance on the evaluation of a loss of chance was given in the *Harmon* case referred to above.)

Article 226 Proceedings

In addition to an action in the national courts, either by way of the regulations or by means of a judicial review, a disgruntled party has the option to lobby the European Commission so as to encourage them to act as a consequence of the breach of the procurement rules. If the Commission is of the view that a member state has failed to fulfill its obligations under the EU Treaty, there is a possibility it would commence proceedings under Article 226. In practice, because of the Commission's extremely limited resources, relatively few Article 226 proceedings are commenced.

BENCHMARKING AND MARKET TESTING

Benchmarking

Benchmarking and market testing are terms applicable in the context of the work of the FM provider in relation to soft services. "Benchmarking" means the process by which the SPV derives information about costs in the market place as a basis for comparison with its own costs or those of its FM provider sub-contractor for the provision of soft services. This may lead to either an adjustment in the payments to the SPV and therefore the FM provider, or it may lead to the provision of soft services by others.

Soft services need not be included at all in PFI/PPP projects; the government department has the option of not transferring soft services staff for PFI/PPP projects, if it is not considered necessary or desirable in the overall interests of the project, or value for money. Where soft services are included, benchmarking and/or market testing may be, but need not be, part of the contractual terms of the concession agreement.

The PFI/PPP market in the UK has only recently begun to attain a level of maturity such that the earlier projects have reached the stage at which benchmarking and market testing are undertaken. There is accordingly as yet little actual experience of difficulties and disputes, although it is not difficult to see potential for disputes, particularly in the earlier PFI/PPP projects.

An example which has been the subject of litigation, but not, it is understood, a decision in the Scottish courts, relates to the Edinburgh Royal Infirmary, Scotland's biggest PFI/PPP project. It appears that the SPV took the view that it was entitled to increased payments on the basis of the findings of its first five-year benchmarking exercise; the Authority is reported to have taken the stance that increased payments would only be due in the event of additional demands on or work scope changes for the SPV. It would seem that lack of clarity as to the terms regarding benchmarking and its consequences may have been to blame for these issues being in contention between the parties and similar problems may give rise to disputes under other projects. Naturally, the reports of this case and the SPV's claim of over £30m over the life of the project raised political concerns over controlling the costs of the operation phase of PFI/PPP projects.

Since soft services may include matters such the costs of energy, labour and food, the cost may well rise steeply over the life of a PFI/PPP project. This does not of course mean that it would not also have risen steeply under conventional procurement. There have of course in recent years been massive increases in energy costs, and over the life of PFI/PPP projects there will be other variances between what actually happens and what was predicted, and between the costs of specific items and the RPI.

It seems likely that at least in the short term, there will be a trend away from including soft services in PFI projects in the UK, as was recommended by the UK government in 2006. One risk with excluding soft services which has potential for disputes is that there will be a potential for contentious issues as to responsibility as between the respective providers of soft and hard services. For example, building maintenance may be affected by the activities of the soft services provider, an “interface” issue that would not arise of the soft services were included in the PFI/PPP project.

There are also other concerns with benchmarking. Are there sufficient comparable data from conventionally procured projects to provide an adequate basis for comparison? Are the contractual criteria for benchmarking capable of objective comparison exercises? What reliable information can be obtained from the market? Is the market willing to provide it? Are there clear provisions concerning adjustment to the Unitary Charge?

HMT’s report of March 2006 states that value for money has not been demonstrated where soft services are included in PFI/PPP projects; standards are said to be no better and no worse where soft services are included. It also notes a significant variation in public sector understanding of soft service benchmarking reviews, before stating that in future the government will require not benchmarking but that the provision of soft services be actively competed for and market tested at appropriate points during the PFI/PPP contract.

The National Audit Office 2007 publication, “Benchmarking and Market Testing the Ongoing Services Component of PFI Projects”, indicates that the two most important lessons learnt to date have been the need to identify good comparable benchmarking information and the need for the Authority to provide sufficient resources, both in terms staff and staff hours, so as to undertake the value testing process with adequate resources.

Market Testing

“Market testing” means the re-tendering by the SPV of the soft services. It is, as stated above, not an area on which any significant experience exists as yet. In fact, in November 2008, reports indicated that only seven per cent of projects which had gone through some sort of value-testing had used market testing. As with benchmarking, there is potential for disputes, particularly, as seems likely, the outcome of these exercises is or is perceived to be major price increases. Again as indicated above, the appearance of substantially increased cost will often in reality be exactly what would have occurred with traditional procurement, rather than, as it may be presented or reported in the media, a case of costs running out of control on PFI/PPP projects. It is possible again that lack of clarity in earlier PFI/PPP projects documentation may give rise to some initial problems. All these potential problems may lead to disputes between the public and private sectors.

Various issues may arise: are there clear provisions on what the re-tendering process entails? Have the parties made due allowance for the cost and time to be devoted to the process? Will new bidders be interested and will they be prepared to contract on exactly the same terms? Where the contract is complex, where for other reasons the entry costs are high or where it is perceived there is a slim chance of winning the work, new bidders will be hard to find. If the answer to either of the two questions above is negative, clear provision is needed in the concession agreement to deal with what then happens. Difficulties and potential disputes over the need to increase the Unitary Charge and by how much are not hard to envisage. If market testing founders for lack of a market, the parties may have to rely on desk-top studies. Since these are necessarily artificial, they can lead to argument. If other strong bidders or at least one is found, will any significant saving and value for money from the process be achieved? If a new provider is appointed, does the project agreement have adequate provision for co-ordination and co-operation on the part of the SPV and its other sub-contractors? Will the upshot of the exercise be substantially increased costs and, if so, how will this be managed from a PR perspective?

There are important issues here, particularly for the public sector. First, as a PR matter, the realistic management of expectations from the outset is a significant political factor. From the disputes management point of view, as is often the case, clear contractual provisions and procedures understood by both parties, with risks clearly allocated and, where appropriate, properly priced by the SPV, are the key to disputes avoidance. From a strategic point of view, the inclusion of soft services in PFI/PPP projects should be sensible and cost-effective. To make it so, there may be some way to go in terms of planning and foresight, and perhaps innovation. There must also be a realistic basis for comparison by way of comparable conventionally procured projects, and not some mythical parallel PFI/PPP universe in which prices stand still for 30 years.

While it may be assumed at first sight that a contractor will be anxious to preserve its position and come through the market testing with its soft service contract intact, this will not always be the case. Market testing may be used by the FM provider to shed those elements of its service provision which may have been unprofitable. The process may be used in this way as a means of either achieving a better return for some aspects of the service provision, with particularly high future costs projected so that the SPV/Authority will either accept the higher service costs, or remove the unprofitable element from the FM provider and have it undertaken by another entity.

A further point is that where there has been a history of performance defaults by an FM provider, market testing may present the SPV/Authority with the information and opportunity to terminate a soft services provider's sub-sub-contract, where the market testing exercise suggests that it could obtain the service either more cheaply or more reliably from others. For this reason, a history of performance defaults will inevitably play a role in the outcome of market testing, even if covertly.

Treasury Guidance on Benchmarking/Market Testing

HMT issued guidance in October 2006, taking into account research by PUK into the early experiences of projects which had reached a stage of value-testing.

The guidance identifies that early and thorough planning, adequate resourcing, accurate comparators and, in the case of market testing, fair competition are all key to provide effective benchmarking and/or market testing procedures. In addition, the guidance also notes the advantages and disadvantages of each process. The guidance concludes that market testing is likely to yield better value for money than benchmarking and is therefore the preferred method of value testing. However, in certain circumstances, such as where these is no or little prospect of competition, benchmarking is more appropriate. The guidance also recommends that advice from departmental Private Finance Units should be sought where benchmarking is proposed instead of market testing

AREAS FOR CAUTION FOR THE MAIN PARTICIPANTS IN PFI/PPP

Different problems can be seen to have emerged for the different participants in PFI/PPP, namely the Authority, the SPV, the construction contractor, the FM contractors and the banks and investors.

The Authority

The Authority's position has generally improved over the past ten years as a consequence of the level of market take-up, and the competition which has resulted amongst those within the market wishing to get into PFI and PPP projects. This competition has inevitably improved the Authority's bargaining position in some respects, and has given rise to economies of scale and increased efficiencies in the process due to the knowledge which has built up over this time. Furthermore, as the risks of PFI/PPP have become clearer over the past ten years, some of the earlier concerns in relation to how such projects might operate in practice have diminished. There have been some real reductions in costs, such as the cost of long-term financing. With this has also come a diminution in some of the financial sector's requirements in terms of guarantees and bonds. This has also led to a reduction in the overall financing costs.

However, there are areas which should sound a potential note of caution for the Authority. There is a long running concern with the high bid costs associated with tendering for PFI/PPP projects (see above on bidding costs). Numerous proposals have been mooted over recent years for managing, or allocating across the market, some of the costs incurred by unsuccessful bidders. It is an issue which requires monitoring on the part of Authorities as if the market perceives that the cost of bidding for projects unsuccessfully outweighs the benefits to be derived for a winning bidder, then participants will be driven out of the market, leading to a reduction in competition.

One way in which this issue has in part been addressed is to select a preferred bidder and for the more costly elements of project development and specification to be undertaken after preferred bidder stage, when the selected bidder has greater certainty associated with the expenditure incurred in preparing the project up to financial close. While this approach can work well, the example of the Colchester General Hospital discussed above demonstrates that there is no guarantee and the result can be seriously detrimental for the contractor. Whilst an Authority might be able to "get away with" this approach on a one-off basis, if it became a feature of the market, there is little doubt that it would drive out competition, and in all probability lead to an increase in the cost of this procurement method as any remaining parties would be forced to build in a recovery element for this risk.

Recent years have also seen a consolidation of the FM provider market. This has been in part led by a realisation on the part of a number of the operatives who moved into this field initially that the margins are not as high as initially anticipated. This rationalisation of the market may itself lead to a reduction in competition with only a few large highly sophisticated and experienced FM contractors being prepared to tender for FM works. Clearly this will potentially lead to a reduction in competition in this area.

Over recent years, some cost reduction has been achieved in the preparation and bidding phase of PFI/PPP procurements through the use of standardised contracts and programmes developed by the public sector. Whilst efficiencies have been achieved through the standardisation of contracts, caution should be exercised that one of the most effective benefits of the PFI/PPP procurement model, is not lost, namely, the preparation of bespoke contracts which more effectively manage and allocate risk between the parties best placed to deal with that risk, and which address the specific needs of the project, rather than adopting a "one size fits all" approach.

As with most employers, Authorities would be well advised to ensure that they manage risks, rather than just passing them down to the SPV. If the risk is not managed, it is inevitable that a party less able to manage a risk, but required to carry the risk, will simply build it into the price. Furthermore, even if the Authority does not invite an immediate up-front increase in the bid submissions it receives as a result of poor management of the risk, there is a potential that, in the long run, if a risk is poorly allocated and an SPV finds itself unable to recover a major liability for which it has become responsible, it will, in the Armageddon scenario, simply become insolvent and allow the financiers to step in and take over the project. This will inevitably lead to greater cost for the Authority, as well as potential disruptions to service, and potentially serious political ramifications.

SPV

One of the areas which must remain paramount in an SPV's approach to PFI/PPP is the way in which it deals with EPR for risks which it carries from the Authority, flowing down to the sub-contracts, or vice versa. If the allocation of risk is not back-to-back, or the provisions which deal with dispute resolution are not back-to-back, enabling decisions concerning liability to be passed up and/or down the line, then a situation can be created where an SPV potentially holds a liability which it cannot either recover from the Authority or lay off against the sub-contractors. This will inevitably have an impact on the liability of the SPV, and indeed its income. In the worst case scenario, it may even lead to the SPV collapsing, or being wound up, as, being a special purpose vehicle, it will not necessarily have any independent assets to meet such liability beyond the income received from the Authority. Some of the difficulties with EPR provisions are discussed above.

A further important issue for the SPV is the cost of disputes. Invariably, the cost of disputes will not have been built into the financial modelling upon which the SPV will have based its calculation of the income required to provide the required facility and services and the cost of funding. If an SPV does not manage these costs and/or ensure that it has a mechanism for recovery of those costs, either from the sub-contractors or indeed from the Authority, a situation may well arise where it simply cannot afford to pursue or participate in the dispute.

One area of emerging interest for SPV's is the effect of secondary investors (discussed above). Secondary investors buying into the SPV will not necessarily have the same knowledge of, or indeed attachment, to the various agreements which the original participants at the time of negotiating the concession agreement and sub-contracts might have had. They may only be interested in reviewing those agreements for the purposes of ascertaining where further money might be made for the SPV. For those who remain a party to the SPV (for example, an FM provider and sub-contractor), this can potentially cause tension between it (particularly if it is a minority shareholder), and the majority shareholders in the SPV who may not be so willing to pass on the income derived by the SPV from the Authority.

The issue of standardisation of contracts is also relevant to the SPV. This is particularly so where an Authority has dictated the use of standard form contracts, which should then be reflected in the agreements reached by the SPV with its sub-contractors. If this is not done, then the potential for a disconnection between the risk allocation in the concession agreement and that between the SPV and its sub-contractors is increased significantly.

Construction Contractors

As mentioned above in relation to the Authority, bid costs remain an area of significant concern for construction contractors and have been the reason for the departure from, or reduction in exposure to, the PFI market for several well-known contractors in the UK.

Construction contractors should also be aware of changing government targets, and new technologies, particularly as they relate to energy usage requirements and energy efficiency. The requirement to meet certain carbon emissions targets and energy efficiency levels has become an increasing facet of PFI/PPP projects. Where contractors are seeking to use new technologies to meet such targets, they should exercise caution in the level of risk which they assume for meeting such targets.

Problems arising out of the energy efficiency and CO2 emissions of buildings can often lead to clashes with the FM provider, seeking to meet certain performance requirements, for which any failures lead to hefty penalties. Careful consideration should be given to the risk allocation under the interface agreement between a contractor and an FM provider.

FM Providers

FM providers are perhaps the parties who face the greatest number of hurdles over the long term. It is inevitable that the landscape within which they are operating will change over time, including changes in the SPV make-up and secondary investors. Inevitably, there will be changes in the service requirements, and discovery of unsecured cost exposures within the financial modelling. FM providers will also have to adapt and deal with changes in government strategy and varying interpretations of performance requirements.

One area where FM providers must tread with particular caution is the passage of communication between those engaged on the site, working with the Authority on a day-to-day basis, and those responsible for controlling the financial model and costings for the project. If there are modifications or variations to the service provision which are agreed at the site, which are not reflected in changes in requests for payment from the Authority, via the SPV, then holes can open up in the financial cost models for the FM provider.

Another area to which the FM provider must pay particular attention is the timely provision of notices, especially those relating to disputes. Further, an FM provider should be aware of, and monitor, the notice requirements for the SPV in relation to disputes with the Authority. If this is not done, a situation may well arise where the opportunity for the SPV to join the Authority directly into the resolution of any dispute, is lost. Similarly there is a need for the FM provider to ensure the effective and timely operation and management of EPR provisions to effect the pass-through of liabilities identified between the FM provider and the SPV to the Authority.

Finally, the FM provider will need to manage the long-term relationships both between itself and the SPV, and itself and the Authority, with whose operatives it is likely to be dealing on a day-to-day basis on the site. This presents its own unique challenges both politically, and commercially, and if careful attention is not paid to it, may lead to disputes.

Banks and Investors

To date, as perhaps might be expected, there have been few problems arising for banks and investors in relation to PFI/PPP projects. However, it remains the case that banks and investors must monitor the accurate management of timings, particularly in relation to notice of provisions concerning disputes, and especially where they relate to a bank's stepping-in rights. The banks and investors should also be aware of potential problems with the cost of disputes into which an SPV might unexpectedly find itself drawn. These will not ordinarily have been accounted for in the financial models.

Whilst it is perhaps the case that competition among participants in PFI/PPP projects has increased, leading to a reduction in certain margins (particularly those relating to long term debt), there has at the same time been an improvement in the perceived risk profile of PFI/PPP projects. However, whilst the risk profile for the initial construction and operation phase appears to have been largely accurately predicted, it remains to be seen whether, in the long term 20 to 30 year period whether the risk allocation associated with service provision and its costs, remain accurate.

DEFINITIONS AND ABBREVIATIONS

"Adjudication" means the process of adjudication contemplated by the HGCR Act or a contractual version of the same thing.

"The Authority" means the party to a contract under the private finance initiative to whom the services are provided.

"Benchmarking" means the process by which the SPV derives information about costs in the market place as a basis for comparison with its own costs or those of its FM provider sub-contractor for the provision of soft services.

"CEDR" means the Centre for Effective Dispute Resolution.

"Concession agreement" means the contract entered into under the private finance initiative, between the Authority and another party, normally involving the design, construction, and operation for a period, typically 30 years, of a PFI project, .

"ECJ" means the European Court of Justice.

"EPR" means equivalent project relief (discussed above).

"FM" means facilities mamagement, which means the provision of services necessary for the operation of the project. These services may include hard services and/or soft services.

"FM provider" means a company providing facilities management services, typically one of the constituents of the SPV providing the services as a sub-contractor to the SPV over the period of the project, *e.g.* over 30 years.

"Hard services" or "hard FM" are defined by the Treasury as "activities that directly relate to the maintenance of the underlying asset (*e.g.* buildings maintenance and refurbishments)".

"The HGCR Act" means the Housing Grants, Construction and Regeneration Act 1996.

"HMT" means H M Treasury.

"Market testing" means the re-tendering by the SPV of the soft services.

"OGC" means the Office of Government Commerce.

"OJEU" means the Official Journal of the European Union.

"PFI/PPP" means the private finance initiative/public private partnership.

"RPI" means the Retail Price Index.

"The Scheme" means the Scheme for Construction Contracts (England and Wales) Regulations 1998, SI 1998 No. 649.

"Soft services" or "soft FM" means the services other than the hard services and includes matters like cleaning, security and catering.

"SOPC3" means the Treasury's standard form concession agreement wording in Standardisation of PFI Contracts Version 3.

"The SPV" means the other party (apart from the Authority) to the agreement, a special purpose vehicle usually in the form of a limited company formed for the sole purpose of performing the agreement. The SPV would typically consist of a funder, a contractor (construction company) and an FM provider and that, unless otherwise stated, is assumed when the expression "the SPV" is used below.