Annex 3

Contract Structure

1. This section gives an overview of the contract. It has been based upon HM Treasury's Standardisation of PFI Contracts version 4 (SoPC4) and the derogations approved by them for waste infrastructure contracts.

Length of contract

2. The contract would cover the period whilst the facility is constructed and commissioned (approximately three years) and a 25 year service period from the date that the treatment service starts. However, the council would not pay the unitary charge until waste begins to be delivered for treatment. The council would repay the significant investment that the contractor would have made to build the facility over the life of the contract. A contract term of this length is used for large waste contracts as it allows the council to repay the financing costs over a longer period of time, in much the same way as a mortgage, and therefore helps the council's affordability position.

3. The contract would be between the council and a special purpose vehicle (SPV) with guarantees and warranties as outlined in the commercial structure as shown at annex 2. The contractor would set this up specifically to build and operate the facility.

Acceptance of waste

4. The facility would be designed to treat residual waste collected at the kerbside and from the household recycling centres which the facility would be required to accept. There would be a limited number of materials that would not be suitable for treatment in an energy from waste (EfW) facility, for example, asbestos, and the contract sets out what these are and the protocol for dealing with them should they be delivered.

Pay and Performance

5. In common with contracts of this type the payment and performance mechanism is based on the principle of 'no service no payment'. The contractor would be paid for each tonne of waste accepted and processed and there would be incentives to ensure that landfill diversion targets are met and the contractor could also receive additional payment if the amount of waste landfilled is reduced.

6. The contractor would receive 'non acceptance deductions' if it failed to accept waste in addition to the loss of the tonnage payment. This covers any additional costs to the council for diverting the waste elsewhere.

Supplementary contract waste

7. The council needs to ensure that the contract can deal with tonnages that are above and below its tonnage forecast at the commencement of the contract. It has therefore negotiated a broad and flexible approach to the tonnages that can be delivered for treatment in the contract. Under this contract the council would be able to access capacity over the council's annual requirements in the event of an unexpected increase in tonnage. Any tonnage delivered to the facility above the council's original forecast is known as supplementary contract waste.

Performance measurement framework

8. The contract would set out the council's requirements for treating residual waste and how the contractor's performance would be monitored in a performance measurement framework (PMF). The aim of the PMF is to provide a proportionate mechanism to incentivise good performance whilst ensuring that the council is not in a position of having to terminate the contract for minor infringements, unless this has become a regular pattern of behaviour. Continued poor performance could therefore ultimately result in termination of the contract.

9. Performance failures would be categorised from A, the highest, to D the lowest (depending on the severity of the failure) and deductions would be made either per occasion or when the failure has not been rectified within the permitted period.

10. The PMF would include a range of measures; such as key operational data including emissions, vehicle turnaround times, cleanliness of the site, availability of the visitor centre, and failure to follow the transport plan (that is using an unauthorised route). Examples of PMF criteria are shown in table 1. The calibration of the PMF would be commercially sensitive. Ultimately failure to achieve agreed standards in the PMF would result in deductions from the unitary charge, and therefore would incentivise the contractor to achieve good performance.

Table 1. Examples of PMF criteria

Example of PMF criterion	Notes
The contractor has maintained consents for the facility.	Consents includes environmental permit, planning permission and any other licences that the contractor would be required to obtain and abide by.
The contractor has ensured that authorised vehicles delivering contract waste to the site are given priority over other users.	As the facility has primarily been built to manage the county's residual waste, council and the district council vehicles would have priority over other users.
The contractor has managed recovered products in accordance with the agreed value recovery plan.	The value recovery plan would detail the by-products and residues produced by the facility and how these would be managed.
The contractor has ensured that vehicles enter and exit the site with closed sheets/nets.	Vehicles would be required to be closed with nets or sheets to ensure detritus/litter/waste is not dropped around the site, on neighbouring property or the public highway.
The contractor has ensured that exiting vehicles do not deposit detritus on the highway.	Vehicles must be in a suitable condition to ensure detritus/litter/waste would not dropped on the public highway.

Calorific Value (CV) risk

11. The CV of the waste determines the rate at which the waste can be combusted by the EfW facility and the amount of electricity that is produced. Every EfW facility will have its own firing diagram (a diagram which shows the relationship between CV and the tonnage of waste that can be accepted). This diagram shows an optimum point (design point) in relation to tonnage and CV and the contractor will try and operate the facility around this point for the facility to be at its most efficient with regards to energy production. The contractor bears the risk of changes to CV of waste within a defined range (agreed with the council) specified as part of the firing diagram. If waste with a lower CV is sent to the facility, the contractor will blend this with waste of a higher CV to achieve the design point (and the greatest energy production), and vice versa.

Supervening Events

12. The contractor undertakes to ensure Service Commencement by a fixed date, however there may be circumstances in which the contractor should fairly be relieved from liability for failure to commence or provide the service. When a contractor is relieved from this liability it is known as a supervening event.

13. There are three types of supervening events:

    a) Compensation events – which are at the council's risk and in respect of which the contractor should be compensated. These would be extremely limited, for example, failure by the council to offer the county's residual waste to the contractor.

    b) Relief events – events in which the contractor bears the financial risk, but there would be no rights of termination of the contract for the council e.g. fire, strikes and failure by a utility provider.

    c) Excusing clauses – where the contractor bears part of the financial risk, but this would be limited to closure of the facility on agreement of the council, e.g. implementation of a change in law and where the council declares an emergency.

Third Party Income

14. The contract produces a number of sources of third party (non council) income. This includes income from treating commercial and industrial (C&I) waste, sale of by-products (e.g. metals extracted from incinerator bottom ash) and electricity.

C&I waste and Metals

14.1 The contractor has guaranteed to obtain an income from C&I waste and metals in the financial model and the council would receive the benefit of this whether this income is received or not. This income would be taken account of within the gate fee. Should the actual amount of income exceed this, then the council would share that income with the contractor.

Electricity

14.2 The EfW facility would produce around of 116,000 Megawatt Hours (MWhr) of electricity per annum.

14.3 In most bank financed projects the authorities are guaranteed only a proportion of the electricity as the bank limits the amount that can be guaranteed and in addition the bank requires the contractor to take a highly risk averse position and negotiate a long term contract with an electricity company. The result is that, for bank financed projects, the council might normally only expect to be guaranteed around two thirds of the potential electricity income as part of the gate fee when compared with a corporately financed project. The council would only have a limited share of any upside with the contractor.

14.4 Given the forecast trend in electricity prices, the council has elected to negotiate a more advantageous contractual position which is innovative. The Government Procurement Service has recently produced a paper on self consumption which it believes is an obvious solution for public sector bodies which produce electricity.

14.5 Under section 11(3) of the Local Government (Miscellaneous Provisions) Act 1976, local authorities are prohibited from selling electricity unless it is alongside heat or comes from a renewable source. The EfW facility does not fall within the list of renewable sources specified and, whilst the facility is heat-enabled, the project does not currently include the use of heat produced at the EfW facility. The mechanics of the proposed electricity structure have, therefore, been designed such that the council would comply with the aforementioned legislation and therefore it will be the contractor who would transfer the electricity to a power company. At such time as the council begins to produce heat this restriction will fall away.

14.6 The contractor would guarantee the volume of electricity produced and would be liable to the council for any failure to meet this volume. The contractor would also be liable to the power company for failing to promptly notify the power company of unplanned outages and failing to provide forecasts of the production of electricity. It should be noted that the council would take the risk if the terms agreed with a power company are not consistent with the terms that are currently set out in the contract that have been agreed with UBB.

14.7 The council would instruct the contractor to sell the electricity to the market via a power company using medium term contracts of three to five years. Alternatively the council could take short term positions and look to benefit from an imbalance in supply. The actual risk position would in practice be something the council would take expert advice on at a later date.

14.8 The council would also have the option to purchase the electricity from the facility under a “netting off” arrangement. This would mean the council has the potential to buy the electricity at less than retail price. If a public body is to consume its own electricity the key issue is how the electricity is transferred from the point of generation to the point of supply. The power company will provide access to the distribution network plus any administration and billing needed. The power company will also manage any imbalances between the supply and the demand for electricity caused by seasonal or other demand factors. They will require reimbursement which is known as the balancing charge. The power company would be prohibited from profiting from the supply of electricity itself originating from the facility.

14.9 There is also an opportunity for the council to benefit further by transferring any surplus to other parts of the public sector such as district councils depending on the council’s electricity requirement. There would be a number of ways in which a sale of electricity to others could be achieved which the council would consider at a later date.

14.10 The council has run a number of sensitivities based on consumption by the council of its own electricity and these are shown in exempt annex 4.

Excess Profits

15. If the contractor makes profits that are above a certain level these would be shared with the council. This would be the first time this has been achieved on a waste infrastructure project.

Refinancing

16. The council has the right that if the cost of money falls, either due to market conditions or if the inherent risk of the project reduces, then it could seek cheaper funding. This would be shared on a sliding scale from 50 to 70%. In addition the council would receive 90% of any gain resulting from better margins.

Break Clause

17. The council has agreed break clauses allowing the contract to be terminated at the 10, 15 and 25 year points for a defined sum payable by way of compensation.

Termination

18. Termination is generally considered an unlikely risk and has only happened on one closed PFI project in the UK to date. Some of the main termination scenarios are:

    a) For a council default the council would either fail to pay the contractor or breach its obligations. By way of compensation the council would be liable for paying loss of profits and the outstanding bank debt. In return the council would receive the assets.

    b) For contractor default the council would be able to agree a re-tendering position which means that after a period of time if a contractor fails to perform, the service would be re-tendered and a new contractor brought in. In such a circumstance the price the council pays remains the same but any rectification needed is adjusted within the purchase price paid by the incoming bidder. If no one bids or an expert determines that the contract has no value then the council would effectively get the facility free of charge.

    c) Under a force majeure termination, because of the ultimate failure to obtain planning, the council would be liable for capped costs relating to bank fees, redundancy costs and any pre planning expenditure but excluding bid costs. The council would also be responsible for the consequences of any financial positions taken on interest and exchange rates.

    d) Where it can be shown that a corrupt gift was made to a council employee and this was not done by a UBB employee acting independently then the council may terminate the contract by paying compensation equivalent to the outstanding bank debt less any losses it suffers.

Change of Law

19. The contractor must comply with all applicable legislation. A failure to comply could give rise to an event of termination for contractor default. The cost of complying with legislation which is current or foreseen at the time of the contract is built into the price the contractor bids to provide the service. Nevertheless, the contractor may not, for example, be capable of including in the price specific costs arising from changes in law which are not foreseeable prior to contract signature.

20. Contractors have in the past expressed concern that change of law is a risk which they cannot control and which they regard as being within the control of the council or wider government. In practice, however, many authorities (particularly local authorities) have negligible influence over legislation whereas the private sector has traditionally proved adept at managing the effects of changes of law and minimising their impact on their business. Hence it is appropriate for the contractor to share in the risk.

End of Contract

21. The facility will revert to the council at the end of the contract term.