SUMMARY

The Central Berkshire Waste project is a success story in terms of collaboration, overcoming challenges and the ability to adapt to changes. This private finance initiative (or PFI, as it is referred to in the UK) is a PPP for waste handling, treatment, transfer and disposal services which was conceived as part of a partnership between the Reading Borough, Bracknell Forest, and Wokingham District Councils. Since the date of financial close, it has lived through turbulent economic and political times, and it is currently operating in an environment that is very different from the time in which it was conceived.

The key event in this project is a difference of interpretation over revenue calculations. The parties had gone through different resolution processes, and the possibility of escalating the disagreement to the UK High Court was considered. However, both parties committed to reaching a negotiated settlement, and in finding a solution they demonstrated the effectiveness of clear communication and collaboration.

SUMMARY LESSONS LEARNED

- Setting up a parallel informal audit to address issues with KPIs which no longer meet the Procuring Authority's goals may, in some circumstances, provide a suitable short-term solution.
Appendix A: Case Studies

- Co-location of the Procuring Authority and Project Company can help to more efficiently resolve issues at an early stage.
- Setting up an informal variation procedure may provide a solution if the formal variation procedure proves to be unworkable. It also highlights the need to set appropriate time periods when negotiating the PPP contract.
- Setting up a small, closed government industry network can have a positive impact on a program of PPPs in a particular sector, including through the sharing of knowledge.
- To help ensure that legal drafting is pragmatic, lawyers should be well supported by people who are involved after financial close, such as contract managers.
- Assigning employees who have not been involved in the lead-up to the dispute to the negotiations may provide independence required to resolve the dispute more efficiently.
- Processes of periodically reviewing KPIs may need to be considered to be included in PPP contracts to keep the project relevant to the needs of the time.
- Setting too stringent KPIs with small payment deductions may not provide enough incentive for the Project Company to achieve them.

**Project Inception**

**Goals and Objectives of the Partnership**

In 1998 the Reading Borough, Bracknell Forest, and Wokingham District Councils found themselves responsible for both disposal and collection of waste due to a change related to the organisation of local authorities. The three councils decided to partner together to address European Union and UK waste targets, which resulted in the creation of a joint committee known as the Waste Disposal Board.

The PPP contract was for the construction of waste handling, treatment, transfer and disposal facilities in Reading and Bracknell, the ongoing operations of these facilities, as well as receipt of municipal waste. The aim of developing these facilities was to increase household recycling to 50% and achieve 75% diversion from landfills no later than 2031.

The procurement partnership (Procuring Authority) was named Re3 to represent the three councils. The Project Company then chose to use the name of the partnership and call itself Re3 Ltd. While both the Project Company and the Procuring Authority carry the same name, there is no common ownership. The Project Company is owned entirely by private investors.

**The Economic and Political Environment during Inception**

The project reached financial close in the third quarter of 2006. At this time the central government was ambitious in promoting private finance initiative PPP projects, and there was strong support for achieving waste targets. Financing for big projects was possible, and local councils were confident that they would be able to continue to pay for large and complex facilities.

The current environment in waste PPPs in the UK is completely different from the environment when the project was initiated. Much of the funding for local authorities in the UK comes from the central government, and after the Global Financial Crisis, and the introduction of austerity measures, the central government started to reduce this funding and support. Local authorities are responsible for funding waste PPPs, and they are finding themselves re-evaluating these projects, as their unitary payments are becoming unaffordable. Currently, two waste projects are under the spotlight in the UK. In Manchester, a project was terminated after re-evaluation by local authorities and private parties, while in Sheffield, the City Council and the Project Company are in discussions over whether to continue.

**Management of the PPP Contract**

**Construction Phase**

The construction phase for the development of the Central Berkshire Waste project did not see any significant disputes or delays. The construction of the facilities was due to take three years, and the Procuring Authority had a three-stage step-up payment mechanism. This meant that achieving certain construction milestones related to the two facilities in Reading and the facility in Bracknell affected the unitary payment, with each step-up increasing the portion of the unitary payment that was payable. This payment mechanism structure was in place to incentivise the Project Company to meet their construction milestones on time.

As the Project Company had taken the risk for design and construction, the construction contractor was self-monitoring the construction with the council monitoring “in the background”. An independent certifier was also appointed by both the Procuring Authority and the Project Company to verify compliance with the output specifications, monitor progress and approve achievement of the construction milestones.

The risk monitoring system used by the construction contractor adopted a programme-based critical path method. This uses the theory of constraints, which is a methodology for identifying the most important barriers to achieving the goal and then improving that barrier so that it is not a limiting factor any more. The progress was...
then continuously compared against the contingency time available (or float), whilst managing the risk of one activity or particular area compromising all the contingency available. The construction was completed on time, however it is difficult to assess how much of this was the result of the risk monitoring system employed by the construction contractor.

The councils were cautious not to take on additional risks, which was in line with the standard waste PPP contract they have adopted (the Waste Infrastructure Delivery Programme (WIDP)\(^1\) Project Agreement). The councils rarely went further than attending weekly update meetings, and interventions were kept to a minimum as any more pro-active interventions would have been perceived as a precedent by the Project Company and could have implied that the Procuring Authority was taking on construction risk.

The sign-off of completion was eventually formalised following a detailed inspection performed by the Procuring Authority, the Project Company, the construction contractor, the operations contractor and the independent certifier.

**Performance Monitoring and KPIs**

There are about 70 Key Performance Indicators (KPIs) in total contained in the PPP contract, including the secondary indicators, and while they are generally monitored by the Project Company and the operations contractor, the Procuring Authority performs a certain level of monitoring as well. The Project Company is currently meeting the KPIs consistently, and any payment deductions are minor. However, a small number of the KPIs are causing some tension, due to the Project Company viewing them as “draconian” and unachievable and the Procuring Authority seeing them as a continuing incentive for performance. This small number of KPIs have relatively low payment deductions and the Project Company’s view is that they don’t incentivise performance.

The KPIs for the project were set at the signing of the PPP contract, over 10 years before the writing of this case study, when the focus was on diverting waste from landfill. The Project Company was given the autonomy to achieve this however it saw fit, for example through incineration of waste. However, current government policy is now more focused on recycling and meeting recycling targets related to the circular economy. The KPIs therefore do not correspond well with the current goals of the Procuring Authority, as the Project Company is able to meet the KPIs without necessarily increasing the percentage of waste that is recycled. The KPIs are considered as “of their time”.

To help address issues which are not fully covered by the current PPP contract, the Procuring Authority introduced a parallel process with an informal audit, reported back to the joint board, represented by Project Company and Procuring Authority members. The audit covers aspects which the Procuring Authority consider to be important, but are not covered properly by the KPIs. These are often more subjective indices, and hence may be better suited to an informal process.

The audit is shared publicly on the Reading Borough, Bracknell Forest, and Wokingham District Councils’ websites, however it is not advertised widely, as it does not exist to apportion blame or criticise the Project Company. Rather, it is published online to ensure that, should the performance with regards to these metrics drop, other councils and local authorities would be able to refer to it and proactively manage their own contracts, either with the same private partner or with others. The Procuring Authority is pleased with this process and did confirm that it was extremely helpful in addressing issues not monitored by the KPIs. The Project Company sees the audit as comprehensive and has no issues with the way in which it is currently implemented. However, this audit is not expected to last indefinitely, as it is not a requirement under the PPP contract and circumstances may change.

**Payment Mechanisms**

For the operations phase, the unitary payment is linked to availability, a minimum tonnage guarantee by the Procuring Authority and subject to payment deductions linked to the performance KPIs. Above the baseline payment, there’s a cascade based on how the waste is treated (i.e. recycling or landfill), and the savings due to avoidance of landfill tax are a principal driver for the Project Company to recycle waste. A gain share mechanism exists, which allows for up to 50% of the savings due to avoiding landfill tax to be shared with the Procuring Authority. However, recently the baseline threshold has not been reached due to a fall in waste tonnage.

Availability payments are only made after the certification is issued by the lenders’ technical advisers. After the facility is certified, the performance-related payments are made based on the operational performance, which is measuring the amount of waste on the basis of weighbridge tickets and evidence of activity.

Over the year, an operational model is used by the Procuring Authority to forecast the expected level of business and type of processing to estimate how the payments will be allocated. Payments made are then reconciled with evidence submitted to ensure the accuracy of revenue calculations. The final reconciliation takes place six months after year-end.

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\(^1\) The Waste Infrastructure Delivery Programme was established by UK Department for Environment, Food and Rural Affairs (also commonly known simply as Defra) to support local authorities to accelerate investment in the large-scale infrastructure required to treat residual waste.
**Change Management**

Any material changes to the PPP contract have to abide by applicable procurement regulations. However, for smaller changes, the parties have found a way to smooth the process. It starts by one party submitting an informal notice of change, which explains the nature of the change and the reasons behind it. Keeping in mind that the change should be within regulations and the remits of the PPP contract, the informal notice is issued one month before the formal notice is issued. This is done to give each party the opportunity to review the notice, suggest amendments, and adapt to its implementation before it is formalised.

**ROLE OF GOVERNMENT**

It was evident that the success of this project was partly due to the support from central government organisations and programmes. Two years from financial close of the project, the UK government initiated the Waste Infrastructure Delivery Programme to support local authorities in accelerating investment. The WIDP provides advice to local authorities and facilitates knowledge sharing between them. The WIDP’s advices come in the form of published guides, and physical presence upon request. The contract management guides produced by the WIDP have contributed to the success of this project, and the knowledge sharing events organised by the WIDP have created a safe environment for local authorities to share knowledge effectively and directly.

WIDP was established by the Department for Environment, Food & Rural Affairs (also commonly known simply as Defra). WIDP provides commercial support to the relevant waste projects in England. For local authorities contracting waste private finance initiatives, the availability and expertise of WIDP acts as a counter balance to the private sector’s commercial capability and budget. This did prove to be instrumental in the dispute, described under the heading “Major Events” below. The dispute process lasted for four years with significant costs incurred due to multiple adjudication proceedings.

**RELATIONSHIP BETWEEN THE PROCURING AUTHORITY AND PROJECT COMPANY**

**Team Set-Up and Staffing**

The Procuring Authority’s project team was hired specifically for this project, and the majority of the members of the Procuring Authority’s team who were involved in the procurement process have remained through the construction phase and into the operations phase. On the contrary, all Project Company staff who worked on the bid moved on once the PPP contract was signed. It was mentioned that there is a level of duplication of roles between the Procuring Authority and the Project Company. This was seen as a poor allocation of resources that contradicts the spirit of the partnership, as there should be no need for two employees performing the same role for each party.

At the moment, the Procuring Authority has four employees working on the project. This was explained to be adequate, and while additional support would be useful this is unlikely to be affordable. For example, the Procuring Authority foresees a need to monitor the Project Company’s financing obligations. The Procuring Authority did express the intention to work with the WIDP on this task.

**Training and Development**

There is no structured training programme in the Procuring Authority’s contract management team. The Procuring Authority did have a training budget, however, it was not fully utilised, and staff training is provided on a case by case basis. The WIDP also provides assistance with guidance and knowledge sharing which local authorities need for their development.

**Communications**

From the three councils that make up the Procuring Authority, Reading Borough Council acts as the administrating authority. Thus, this council takes up the role of leading communications with the Project Company and stakeholders. The current strategy for public outreach is through social media, which has proven to reach more people at a lower cost than the previous arrangement of scheduling public meetings.

The Procuring Authority and the Project Company are co-located in a single location for the operational management of the PPP contract. This has helped greatly in building a strong relationship between the parties. The day to day interactions acted both as a deterrent to hostile behaviour and facilitator in building strong relationships. The nature of the relationship has matured to the extent that both parties continued to operate amicably even after a period in which they took wholly different positions on the sharing of revenue.

**Information Management**

Both parties started with a shared information platform for data sharing, however this proved to be more complicated than was required for a project of this scale. The remedy was to take advantage of the co-location set-up and work together instead of using a virtual space.
KEY EVENTS

Dispute – revenue calculations

In 2010 a formal notice of dispute was issued by the Procuring Authority, five years after financial close, regarding the calculation of excess revenue. The parties went through multiple adjudication proceedings, and the dispute was almost escalated to the High Court before a resolution was reached for the benefit of each party.

One of the factors leading to the dispute appears to be a reduction in amount of waste collected from 2009 onwards. The reasons behind this reduction are hard to pinpoint to one single cause, as an interplay of various factors probably contributed to this, such as demographics (e.g. changes in local population, the nature of residential developments), a reduction in consumption (and hence waste generated) due to the Global Financial Crisis, or changes in local authorities’ operational policies (e.g. collection versus disposal). The reduction in tonnage changed the financial outcomes for the Project Company, and in this context financial flows and payments came under close scrutiny. This led to the Project Company interpreting the PPP contract in a different way to the Procuring Authority, which took the view that the Project Company was withholding payments related to excess revenue.

While there were provisions in the PPP contract for dealing with disagreements of this kind, eventually the parties reached a stalemate. From the point of view of the Project Company, this was broken by bringing in people who had strong relationship building skills who then focussed on improving the relationship with the Procuring Authority. As the staff were new, they had a more independent view as to what had occurred previously and were able to take a more pragmatic approach.

It is important to note that the lack of agreement on the precise workings of the PPP contract, as well as ambiguity in the PPP contract itself, led to this dispute reaching a stalemate. A difference in views between two parties to a contract is common, especially given the length and complexity of this kind of project, and the challenge is therefore to find a way to overcome these disagreements without risking ending up in dispute. In this case a better understanding of what the PPP contract required would have helped improve outcomes for all parties.

As part of the solution adopted, the parties have negotiated some changes to the PPP contract conditions and payment mechanism to provide additional clarity and remove any residual ambiguity.

LESSONS LEARNED

Setting up a parallel informal audit to address issues with KPIs which no longer met the Procuring Authority’s goals may, in some circumstances, provide a suitable short-term solution.

An informal, parallel audit is conducted on aspects that aren’t well covered by the KPIs in the PPP contract. The Procuring Authority introduced the parallel process, which is reported back to the joint board, represented by Project Company and Procuring Authority members. The audit covers aspects which the Procuring Authority consider to be important, but are not covered properly by the KPIs. This is published online, and has encouraged the Project Company and the operations contractor to improve their performance in these areas.

This is a salient point both in terms of the issues with the initial setting of KPIs in a PPP contract at its signing and also outlines an approach to dealing with outdated KPIs.

Co-location of the Procuring Authority and Project Company can help to more efficiently resolve issues at an early stage.

The Procuring Authority and the Project Company are co-located in a single location for the operational management of the PPP contract. Co-location of the offices helps greatly with relationship building on a day-to-day basis, and in particular during challenging times, such as disputes. Face to face interaction between the parties helps to resolve the issues before they are escalated through the formal contractual mechanisms.

Setting up an informal variation procedure may provide a solution if the formal variation procedure proves to be unworkable. It also highlights the need to set appropriate time periods when negotiating the PPP contract.

The parties have introduced an informal variation procedure which they go through before the formal notice stipulated under the PPP contract is issued. This helps both parties familiarise themselves with the change, and allows tweaks to be made before it is introduced formally. Change orders and variations during the operations phase are in many instances driven by changing market needs and any changes in the Procuring Authority’s policies or other external factors, which is common in long-term PPP contracts.

This practice, in this case, demonstrates a successful method of addressing the issue of variation procedures in the PPP contract that do not provide the parties with enough time to familiarise themselves with the issues. It also highlights an interesting lesson for the drafting of PPP contracts and the need to set appropriate time frames within the variation procedures to allow the parties to deal with the issues properly.
Setting up a small, closed government industry network can have a very positive impact on a program of PPPs in a particular sector including through the sharing of knowledge.

A small, closed industry network, such as the WIDP in the UK, helps promote best practice and knowledge sharing. The members are comfortable to talk openly to their peers and share lessons learned, and the WIDP has also issued a contract manual which is widely used and considered helpful. This kind of network can provide transactional support and any other contract management advice on specific issues, and helps the members stay abreast of topical issues and challenges faced by fellow members.

To help ensure that legal drafting is pragmatic, lawyers should be well supported by people who are involved after financial close, such as contract managers.

It is important, to minimise areas of ambiguity, that when drafting the PPP contract, both parties agree on terms and processes addressing interfaces and grey areas in the PPP contract before contract signing where possible to mitigate the risk of different interpretations and disputes. Lawyers should be well supported by contract managers and other relevant people involved after financial close to ensure legal drafting is pragmatic.

Assigning employees who have not been involved in the lead-up to the dispute to the negotiations may provide independence required to resolve the dispute more efficiently.

It is natural for people who are involved in a disagreement to have strongly held views. When a dispute escalates, it can be beneficial to involve employees who have not been involved in the lead-up to the dispute and focus more on relationship building and negotiation.

Processes of periodically reviewing KPIs may need to be considered to be included in PPP contracts to keep the project relevant to the needs of the time.

The nature and length of PPP contracts demands some degree of flexibility for reviewing and re-assessing KPIs. The needs of the market and the users will not likely remain the same all the way through to the end of a project as they were during inception. KPIs should be reviewed regularly to assess whether they have become outdated with regard to the current market or public needs. Processes of reviewing, adding, or discarding KPIs may need to be considered to be included in the PPP contract in order to keep the project relevant to the needs of the time.

Setting too stringent KPIs with small payment deductions may not provide enough incentive for the Project Company to achieve them.

There are about 70 KPIs in total contained in the PPP contract. The Project Company is currently meeting the KPIs consistently, and any payment deductions are minor. However, a small number of the KPIs are causing some tension, due to the Project Company viewing them as “draconian” and unachievable and the Procuring Authority seeing them as a continuing incentive for performance. This small number of KPIs have relatively low payment deductions and the Project Company’s view is that they don’t incentivise performance.