# The new standard form contract for waste projects

This week saw the publication of the latest residual waste treatment contract by the Department for Food and Rural Affairs ("DEFRA") in conjunction with the Waste Infrastructure Delivery Programme ("WIDP"). The new contract follows up on the previous project agreement issued by WIDP in June 2009 and the "Direction of Travel" paper, which was issued by WIDP precisely a year ago.

The Direction of Travel paper provided a useful insight into where the new contractual regime was heading in WIDP's view and formed the basis of many negotiations since December 2009. It also built upon the original DEFRA derogations to SoPC4, which were issued in 2006.

The industry will no doubt spend the next few months analysing in detail the changes that this latest contract has brought to the table. For those deals which are yet to close dialogue, it is likely that the new contract may play a significant role. Before looking at some of the changes in detail, it is worth looking at the background and development of the latest document.

**Background**

The contract is the much awaited successor to the previous form of contract issued by WIDP in June 2009. The 2009 version, although agreed by most as being a welcome step forward in the standardisation of waste PFIs, still contained a number of issues which made the contract difficult for sponsors and funders in the market to get completely comfortable with. Many of these issues were raised by the industry in the previous round of consultation. DEFRA and WIDP promised to look at such issues at a future stage but until that time, the industry was informed that all derogations from the 2009 version had to be justified on a project specific basis.

WIDP were able to offer the industry some comfort in relation to issues such as the "Option 1 – No Retendering" issue and wipe clean provisions by virtue of the Direction of Travel paper but the formal drafting still had to be agreed on a case-by-case basis.

Nonetheless this still invariably led to many hours around the negotiating table for stakeholders involved in waste PFIs to discuss the reasons why various amendments to the 2009 contract were required and the form such amendments should take. More recently, it has been reported that certain projects which had begun life based on the 2009 contract, were encouraged to adopt new drafting (at a time when such drafting was largely unseen to the industry) which has now appeared in the latest standard form.

Leaving aside for the moment the question about what role the new contract will in fact play in a waste sector now facing a period of introspection in the aftermath of the recent Comprehensive Spending Review, the key question which is posed by the issue of the 2010 contract remains "Does the new contract now address all the industry's concerns?" Before answering this question, perhaps it is useful to briefly analyse some of the long running concerns.

**Can one size fit all?**

Waste PFIs have always been problematic from a standardisation point of view for the simple reason that the majority of standardisation either relates to accommodation type deals (i.e. schools, hospitals, civil defence) and/or deals where the technology is tried and tested (i.e. street lighting). Waste PFIs (much to the chagrin of those involved) unfortunately do not fall squarely within either of these two categories.

The reasons for this are numerous but the key differentiation from other projects relates to the novel complex technologies that are involved in each project and the fact that issues such as planning, operation and maintenance and third party income feature far more prominently than in other types of PFI. In addition, waste PFIs present a myriad of other sector specific issues which again present further challenges for each project. The key areas where such issues arise include but are not limited to permitting, substitute waste, offtake contracts and composition risk.

With these points in mind it is worth looking at some of the high level changes that have been introduced by the new contract.

**What are some of the key changes?**

There are a number of minor/clerical changes (albeit changes to key areas of the contract) which are not the focus of this article but in terms of some of the key conceptual changes, these include the following:

*Waste Collection Authority (WCA) Baseline (Schedule 31 Part 1)*

Although the concept of a baseline has been included in previous waste PFIs, there has always been a little uncertainty as to what they should cover. The new contract does not provide any drafting in this respect but includes a guidance note setting out how such documents are to be treated and basically acknowledges that the WCA Baseline is aimed at dealing more with the effect of any changes in WCA collection activity as opposed to changes in composition. The new contract does acknowledge that information pertaining to the WCA Baseline should be made available to bidders early in the process. This move is to be welcomed as based on recent experience, baseline issues often have been discovered late in the procurement process leading to a flurry of technical activity to ensure waste flow projections and the like are adequately finalised.

*Waste Acceptance Protocol (Schedule 31 Part 2)*

In terms of the waste acceptance protocol, the guidance is clear in its aim of ensuring that the protocol should be a document limited to high level issues such as setting methods for inspection of waste and agreeing whether items such as ad hoc waste are present. The guidance points out that the protocol is not an item for passing risk back to the local authority for rejected waste types, composition or tonnage variation. This may still require close examination on each project as historically waste acceptance protocols have been used to deal with composition risk issues. However the narrowed scope may be less problematic on the basis that the contract does deal with the issue of composition risk elsewhere (as discussed below)

*Composition risk (Clause 23)*

The public sector has always been clear in its view that local authorities should not, if at all possible, accept composition risk in relation to the contract waste accepted at a facility. Although the new contract does not amend this overall principle, it does recognise that if there has been a "material departure" from the WCA Baseline then this could allow the change mechanism to apply with the local authority being required to issue a change notice if they agree that a "material departure" has occurred. Although the mechanism is sensible in its approach it appears that much will still turn on what a "material departure" is and more importantly what effect such departure would have on the contractor's obligations and the operation of the facilities.

The contract points to possible changes in biodegradable municipal waste content and/or changes in calorific value as the potential pivotal points for instituting a change (presumably to cover issues which are prevalent to both, energy from waste and microbiological technology plants). However, this new mechanism would not appear to circumvent the debate between contractors and authorities of determining what a "material departure" is in the first place and what tolerances (if any) the contractor has to bear in relation to a variation in the operation of the plant before the change mechanism can be introduced.

*Substitute Waste (Clause 25)*

The substitute waste provisions have largely been left untouched from the 2009 contract and contractors have started to become more comfortable in relation to the mechanics. However the new contract acknowledges that the ability of the contractor to comply with the substitute waste provisions will be determined by a number of factors including not least each contractor's individual ability to source third party waste. However, in addition, an important drafting clarification has been included to help deal with the question as to what "reasonable endeavours" are in the context of the contractor having to source substitute waste before claiming any relief.

The drafting essentially states that the contractor (and its sub-contractor): *"shall act as a prudent waste operator would act (in accordance with the principles, inter alia, of the Substitute Waste Plan) in order to secure waste for its own facility having the capability of the Facility"*. The inclusion of any definition is useful in this context as the consequences for failing to use reasonable endeavours would deny certain relief to the contractor. However it is arguable that the current words used refer to a test that was implicit in the undefined use of the term reasonable endeavours in this context but the link to the Substitute Waste Plan remains useful as it acts as the document against which the test can be measured to a certain extent.

*Qualifying Change in Law and Insurance Clawback (Clause 44 and Schedule 10)*

WIDP have suggested that local authorities ought only to pay for change in law costs and Exceptional Cost (or in other words their share of increases in project insurance premia during the service period) in proportion to which such costs are related to their usage. Ideally contractors would want such costs to be shared proportionately. However the contract seems to state that to the extent that the local authority has paid for any change in law which affects third party capacity then such costs should be "clawed back" from excess third party income.

This is a concept that has been resisted by contractors in the past but appears to have been batted back. The arguments against this concept suggest that the authority should not be allowed to recover such costs as invariably such third party capacity will eventually generate third party income which is ultimately shared with the authority. The proposed clawback could involve an element of double recovery which the contractor itself does not receive. The other consequence of this policy could be to reduce the incentive to create plants with excess capacity due to the clawback having to be paid to the authority after a change in law. The reasons for wanting to clawback any Exceptional Cost incurred by the authority seem to be even less clear as market variations in insurance premia over the service period are not within the control of the contractor.

It is to be noted that WIDP have proposed that the clawback only apply to excess third party income and so there is a case for stating that this is an element of "super-profit" against which the local authority should be allowed to clawback any costs they have incurred.

*Planning (Schedule 26)*

In terms of the planning schedule, further tidy ups have been incorporated which were alluded to in WIDP's Direction of Travel paper and these bring clarity to certain mechanisms whilst others reinforce the importance of continuing to agree definitions like Satisfactory Planning Permission and Appeal Contingency on a project specific basis. However there has been explicit reference to the issue of what happens if there has been a delay (as opposed to a failure) to obtain planning permission.

The contract states that such delay should not be a Compensation Event and instead that individual heads of loss should be worked up and formulated in terms of quantum. This will be bad news to many including the banking community who have asked WIDP during the course of this year (during various meetings with WIDP and HM Treasury officials) to allow a Compensation Event on the grounds that it is a simple pre-existing mechanic for compensation due to a delay. The overriding policy principle seems to have been that local authorities should not accept open ended liabilities of this nature, particularly in

relation to planning. The mechanics suggested by WIDP to deal with the delay issue include setting out any increased EPC costs (to the extent that EPC costs are not fixed until the construction longstop date) or financing costs associated with delay.

This leaves a wide area for discussion between parties both in terms of quantum and the actual mechanics for dealing with an as yet unknown delay. The guidance and drafting is also silent about the treatment of lost third party income for the sponsors as a result of a planning delay. Presumably the reference to recovery of increased financing costs has been included to ensure waste PFIs remain bankable and ease the pressure put on WIDP by the banks, however query whether such appeasement remains at the cost of sponsor returns.

*Permitting (Schedule 27)*

In addition to the point noted above re compensation for delay, the permitting schedule has included many similar amendments to the planning schedule which have added clarity, including, a right to receive confirmation from the authority that the contractor has used "All Reasonable Endeavours" in attempting to obtain a satisfactory permit. This right exists in the planning schedule and is an important step in allowing the contractor to obtain relief in the event of planning/permit failure.

However the key change to the permitting regime does in fact relate to the compensation on termination provisions which state that failure to obtain a satisfactory permit (after having used All Reasonable Endeavours) will result in termination on the basis of force majeure. This now means that planning and permitting now enjoy the same compensation treatment as opposed to the 2009 contract where compensation for permitting failure only resulted in payment of senior debt.

This will be welcome news for many contractors who have long argued that planning and permitting should be treated the same. The new drafting may pose some interesting questions for contractors who had previously been required to accept full permitting risk. The fact that WIDP have recognised the difficulties may lead some to query the logic of continuing to accept this risk (on projects which have not yet reached financial close).

*Compensation on Termination (Schedule 17)*

As per the planning/permitting schedule, this has been updated to include clarificatory amendments. However, express drafting has been included to deal with the "Option 1" derogation which was first highlighted in the DEFRA 2006 derogations guide and again in the Direction of Travel Paper. The drafting still states that if the derogation is required then it must be time limited and presumably the derogation will be evaluated on the basis of the length of time included, namely no derogation will receive top marks and a derogation asking for the Option 1 derogation to be adopted for the life of the Project will receive lowest marks (as well as requiring WIDP/IUK approval).

In addition drafting has also been included to allow bidders to bid back a cap for each of the three heads of loss in the event of a failure to obtain a planning or permit failure. These are in accordance with the Direction of Travel paper and have been the subject of many recent deals whereby bidders are asked where possible to absorb bid and development costs. These have been forming a key part of bid evaluations with permitting and planning being subject to different caps. It looks as thought this approach is to continue.

**Other changes**

In addition to the key changes noted above, other amendments (which have been requested by the banking, sub-contract and sponsor community) have been incorporated dealing with such issues as:

- *Economic reinstatement test;*

- *Amendment of offtake provisions to deal with (inter alia) potential SRF offtake scenarios;*
- *Inclusion of "wipe clean" provisions;*
- *Updated change protocol (including more "drop down friendly" drafting)*
- *Cap on breach of statutory duty and drafting to avoid "hair trigger" use of limb (a) of the definition of "Contractor Default".*

These changes are in addition to various clerical changes and minor drafting amendments some of which were identified in the WIDP Direction of Travel paper. These will be looked into more detail by legal advisors no doubt over the coming months but on an initial view many of the changes albeit minor help to bring clarity to a number of clauses which regularly appeared on derogation tables.

**Conclusion**

The arrival of the new contract will involve the waste sector getting to grips with the new drafting over the coming year. Many of the new provisions will not be a surprise to the industry as WIDP and local authorities have intimated over the last year that such drafting and concepts would form part of the new contract but at last the proof has arrived.

However the pattern that seems to be developing on review of the new contract is the public sector's desire to push more risk onto bidders in terms of potential cost exposure. The most vivid examples of this are in relation to caps on development and breakage costs for planning/permitting failure and potential clawback of change in law expenditure by local authorities as well as the refusal of a Compensation Event for planning/permitting delays.

There are a number of areas which presumably will remain of concern to stakeholders and others where detailed negotiation will still be required (particularly in relation to compensation for delays, caps and composition risk) in spite of the new contract. WIDP have stated in their covering letter that the contract is intended to provide flexibility for authorities and bidders to reach mutually acceptable positions on the guidance drafting (as opposed to the required drafting which continues to require WIDP and IUK approval). On this basis it is likely that further addendums or versions may be issued.

However this leads to another and perhaps the biggest question that the new guidance doesn't address, namely, will this drafting be required for projects which have closed dialogue on the old form of contract but not reached financial close? In terms of the wider question of how many more new PFIs will use this new standard form given the recent cutbacks, this is something the industry may have to adopt a "wait and see" approach to pending any further updates from WIDP or DEFRA.

In the meantime, all those involved in current procurements based on the previous WIDP drafting are advised to discuss the implications of the new drafting with their advisers.