

## REPORT TO PLYMOUTH CITY COUNCIL

### ADVICE ON CONTRACTUAL ISSUES IN CONNECTION WITH THE ENERGY FROM WASTE FACILITY

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## Report to Plymouth City Council on Options Relating to Waste Treatment Contracts

### 1. Scope of Review

- 1.1. We have been asked to consider whether Plymouth City Council (“the Council”) can lawfully withdraw from:
- (a) the Joint Working Agreement (“JWA”), dated 28 April 2008, between the Council, Devon County Council and Torbay Council, which established the South West Devon Waste Partnership (“the Waste Partnership”); and
  - (b) the Residual Waste Treatment Contract (“Project Contract”), dated 25 March 2011, between the Waste Partnership’s members and MVV Environment Devonport Limited (“MVV”), whereby MVV was required to build the waste treatment facility (“the Facility”) at North Yard for handling the Waste Partnership’s combined waste.
- 1.2. If it is possible to withdraw from the above contracts, we have also been asked to explain how such withdrawal would take place, and what the legal, financial and operational consequences for the Council would be.

#### *Methodology*

- 1.3. We are, of course, aware of the background and sensitivities surrounding the JWA, the Project Contract and the Facility’s location. Our role is to provide robust, fact-based, independent advice in response to the questions set out above. We understand that a key aim of any withdrawal from the relevant contracts would be to stop the Facility being built at North Yard, and have factored that into our advice.
- 1.4. We have focussed our advice on the JWA and the Project Contract (and, to the extent relevant, to considering any possible withdrawal of PFI credits, the Final Business Case and the Promissory Note and PFI Credits Letter issued by Defra).
- 1.5. MVV is not in breach of the Project Contract, and nor has there been any “Prohibited Act” (which is essentially bribery or corruption of public officials), which would allow the Waste Partnership to terminate the Project Contract for Contractor Default.
- 1.6. We will give broad indications of the extent of the likely exposure which the Council would have arising from the respective options to withdraw. In the event of a withdrawal, the sums payable will be extremely significant to the Council and are likely to run into hundreds of millions of pounds. The precise amounts would be calculated by reference to claims that would be made at that time.

## 2. Executive Summary

- 2.1. There is no scope for successfully arguing that either the JWA or the Project Contract was entered into unlawfully (and is therefore void in the first place), so a legitimate withdrawal becomes necessary if the Council wishes to exit from the arrangements.
- 2.2. It is possible for the Council to lawfully withdraw from the JWA and the Project Contract, but:
- (a) to do so would almost certainly be extremely expensive – with a figure in hundreds of millions of pounds being likely (the precise amount depending on the specific circumstances and method of any withdrawal);
  - (b) at an operational level, the Council would effectively still need to find an alternative waste disposal solution to meet its needs;
  - (c) the political repercussions, in terms of relations with Devon County Council and Torbay Council, as well as in terms of the Council’s attractiveness as a business partner in the wider commercial marketplace, warrant consideration; and
  - (d) perhaps most crucially given current concerns within the Council, **the Council withdrawing from the JWA and / or the Project Contract would not necessarily stop the Facility being built at the North Yard site.**
- 2.3. Because withdrawal from the relevant contracts seems unlikely to be an attractive option both in terms of preventing the construction of the facility and because of the significant financial implications, we have also briefly considered whether any variation to the scope of the Project Contract would achieve the aim of re-siting the Facility, but:
- (a) such a material amendment is likely to be beyond the scope of what the Waste Partnership can legitimately require MVV to do (even if the Council could convince the other members of the Waste Partnership to agree to it, which must be in some doubt);
  - (b) even if this difficulty could be overcome, it is likely to lead to a legal challenge from unsuccessful participants in the original procurement exercise, and;
  - (c) Defra would almost certainly have the right to withdraw the PFI credits awarded to this project, and for these reasons we do not consider this to be a viable alternative to withdrawal.
- 2.4. We have also briefly considered whether or not there may be scope to prevail upon the MoD to use any termination provisions in the lease for the Facility’s site to effectively halt construction. We do not consider this to be a viable option.

- 2.5. We have also briefly considered using the contract variation mechanism under the Project Contract (by agreement with the other Waste Partnership members) to temporarily halt construction whilst alternative solutions are re-explored. Again we do not consider this to be a viable option for the Council to pursue.
- 2.6. We therefore see no sure-fire options which would enable the Council to withdraw from the relevant contracts and / or prevent construction of the Facility at North Yard without the Council incurring significant claims for breaches of contract under the existing contractual documents from MVV, Devon County and Torbay that would result in the payment of significant sums of compensation running into hundreds of millions of pounds . Even if the Council did withdraw from the relevant contracts, this would not now necessarily stop construction of the Facility at North Yard.

### **3. Detailed Analysis – Withdrawal from the JWA**

- 3.1. We have first considered whether there is any merit to any argument that the JWA was entered into by the Council *ultra vires*, i.e. in excess of its powers. If it was, this would mean that the JWA (at least so far as it concerns the Council) would be legally treated as if it had never existed, which would in turn mean that there would be no need to “withdraw” from it.
- 3.2. We have found no evidence that the Council entered into the JWA *ultra vires* would succeed – section 101(5) of the Local Government Act 1972 clearly contemplates this type of arrangement, the JWA concerns a legitimate function of the Council, and the necessary procedural steps were taken by the Council when entering into it.
- 3.3. The project is now in what the JWA defines as the “Service Phase”, meaning that the Council can lawfully withdraw from the JWA on giving the other Waste Partnership members 24 months’ notice. The required form of notice is simply in writing and addressed to the Chief Executive of each of the other Waste Partnership members, at their principal offices.
- 3.4. However, this ability to withdraw entails certain operational and financial consequences which may affect its practical viability:
- (a) construction of the Facility would (assuming no undue timetable slippage) be nearly complete by the time such withdrawal takes effect;
  - (b) the Council would remain financially liable under the Project Contract and the JWA, even after such withdrawal from the JWA

- (c) the Council would have to pay the other Waste Partnership members any losses they may suffer as a result of such withdrawal
- (d) the Council's withdrawal from just the JWA would not affect the Project Contract or the Planning Consent, meaning that, by itself, such withdrawal would have little impact in terms of stopping construction of the Facility at North Yard;
- (e) the Council would cease to have a "seat at the table" of the Waste Partnership, meaning its ability to influence and oversee operational matters would be significantly curtailed; and
- (f) such withdrawal would be likely to have adverse political consequences, both in terms of how the Council is seen as a business partner in general, and how willing Devon County Council and Torbay Council will be to engage in significant collaborations with the Council in future.

3.5. To expand on the financial impacts referred to above:

- (a) The direct consequence for the Council of any withdrawal by the Council from the JWA in terms of existing financial liabilities under the JWA and Project Contract would be as follows:– the Council would continue to owe what it already owes under both contracts (i.e. its share of the monthly payment and any other financial commitments under the Project Contract, and its share of any "Contract Management Costs" as set out in Schedule B to the JWA).

However, if withdrawal from the JWA is also accompanied by the Council deciding not to deliver its waste to the Facility, this would:

- (i) in practice mean that the Council would be paying twice to dispose of its waste – once to honour its ongoing obligations under the JWA / Project Contract, and again in respect of the actual disposal of its waste to a third party; and
  - (ii) make it harder for the other Waste Partnership members to fulfil the Minimum Tonnage requirement under the Project Contract, in turn making it more likely that they would have to pay MVV an additional amount [per tonne actually delivered] than would be the case if the Minimum Tonnage was met, with the Council then having to bear most or all of that additional amount
- (b) It is hard to precisely quantify the level of any losses which the other members of the Waste Partnership would suffer as a result of the Council's withdrawal from the JWA – clause 17.2 of the JWA refers to certain types of loss, including re-procurement costs, and increased Landfill Tax and LATS costs associated with not being able to access the Facility, but we do not consider these to be types of loss which would arise just as a

result of the Council's withdrawal from the JWA (because it does not automatically follow that just because the Council has withdrawn from the JWA the whole project collapses and needs to be re-procured / is unavailable for use by the other Waste Partnership members). It should however be clearly understood that it is highly likely that these sums would be significant

A more likely type of loss is the potential for Defra to withdraw PFI credits on the basis that the Council's withdrawal represents a "departure from the approved Final Business Case" In theory, Defra could take a range of steps, including ceasing payment of all future PFI credits, and recovering any PFI grant already paid (of which there may not be any given that the Facility is not yet operational). In practice, whether or not Defra takes such steps will largely depend on what impact the Council's withdrawal from the JWA has on the viability of the overall project, and it is hard to see how withdrawal from the JWA by itself could have such a material impact that it causes Defra concern – it is more likely to be withdrawal from the Project Contract which would raise such issues. However, the risk remains that the Council could have to pay out to cover losses incurred by the other Waste Partnership members arising from the Council's withdrawal from the JWA, and if such losses include withdrawal of PFI credits then the amounts involved could run well into hundreds of millions of pounds.

#### **4. Detailed Analysis – Withdrawal from the Project Contract**

4.1. The first point to note when considering the Project Contract is that the Council is not the only counterparty to MVV (i.e. it is not the only entity comprising "the Authority", which means that:

- (a) the Council cannot unilaterally terminate the Project Contract – it would need Devon County Council and Torbay Council to agree to do that (which is most unlikely in the current scenario); and
- (b) as a consequence, even if it is possible for the Council to exit the Project Contract, the Project Contract will continue to exist as between MVV and the other members of the Waste Partnership.

4.2. Turning now to what is meant by the Council "withdrawing" from the Project Contract, there are three possibilities which we can see:

- (a) a termination of the Project Contract as a whole, requiring agreement and concerted action from all members of the Waste Partnership;
- (b) the parties agreeing to the Council ceasing to be a party to the Project Contract; or

- (c) the Council unilaterally declining to support the Waste Partnership's obligations under the Project Contract.

4.3. Taking the above possibilities in turn:

**Termination of the Project Contract by all members of the Waste Partnership**

- (a) It is currently hard to see why the other members of the Waste Partnership would agree to a concerted termination of the Project Contract, given the significant and negative financial and operational consequences of doing so, including:
  - (i) under Schedule 17 (Compensation on Termination) to the Project Agreement, such a voluntary termination by the Waste Partnership would see the Waste Partnership having to pay MVV (in summary) redundancy costs, costs associated with terminating MVV's sub-contracts, costs arising from early termination of MVV's foreign currency hedging arrangements, an amount to cover MVV's projected future (and now lost) income from contracts with third parties (including the heat and energy supply agreements with the MoD), and a profit element (less an amount representing what MVV's projected costs would have been had the Project Contract run its course and also, where the Waste Partnership does not require the site lease to be assigned to it (which would not be the case if stopping construction was the goal), less the value of the site – it is self-evident that these would be very substantial amounts, running into hundreds of millions of pounds;
  - (ii) the fact that the costs of the original procurement would effectively have been wasted, and more costs would need to be incurred to procure any replacement solution;
  - (iii) the need to continue existing landfill waste disposal options, at greater expense (and associated environmental impact), at least until an alternative solution is put in place;
  - (iv) the loss of PFI credits from Defra (with no guarantee that any new PFI credits would be forthcoming for any replacement solution) – a loss of £95 million at today's values, or £177 million when indexed over the life of the existing project; and
  - (v) the real possibility that any alternative solution would be more expensive than the existing MVV solution (which entails gate fees which are significantly below the national average).

### **The parties agreeing to the Council ceasing to be a party to the Project Contract**

(b) It is unlikely that the other parties to the Project Contract (and this would need to include pMVV) would agree to the Council ceasing to be a party, especially since this would mean that the remaining Waste Partnership members would have to bear a greater share of both the cost and the need to supply the Minimum Tonnage of waste, and would make it far less likely that the Facility would be able to operate at maximum capacity (and may even damage MVV's ability to honour its commitments to the MoD and others under its various contracts to provide / process heat, power and other incineration by-products). There is also the possibility that at least the Council's "share" of the PFI credits would be withdrawn and possibly that all PFI credits would be withdrawn

### **The Council unilaterally declining to support the Waste Partnership's obligations under the Project Contract.**

(c) The Council's main obligations (in the ordinary course of things) under the Project Contract consist of:

- (i) paying its share of the monthly payment due to MVV; and
- (ii) contributing to the Waste Partnership's ability to meet the Minimum Tonnage threshold (the Project Contract provides that if the Minimum Tonnage is not being met that the Waste Partnership will have to pay more to MVV, rather than being a breach of contract).

A "withdrawal" may therefore consist of the Council not fulfilling these obligations. The way in which the Project Contract and the JWA work together means that even if the Council does not deliver any waste to the Facility, it is still obliged to pay its share of the monthly payment to MVV (and possibly more, if the overall Minimum Tonnage is not met). Therefore, even though in theory the Council could stop paying MVV, it would be in breach of contract, and either MVV could claim the due payment as a debt from the Council, or it could claim the Council's share of the payment from the other Waste Partnership members, who could in turn claim it from the Council under the JWA – so the Council would ultimately still end up paying the relevant sums and these sums are large with the compensation under the Project Agreement running into hundreds of millions of pounds. In addition of course there would be the claims that could be made by Devon County Council and Torbay Council.

If the Council does not pay its share of the monthly payment MVV could instead opt to terminate the Project Contract for Authority Default and claim compensation, but in practice it is unlikely to want to do so unless the profit projections in the project's



financial model look to be significantly more favourable than what can actually be achieved, and in any case the other Waste Partnership members would almost certainly avert such a termination by paying MVV the amounts owed by the Council and then reclaiming them from the Council under the JWA – which they can still do even after the Council has withdrawn from the JWA.

Again, there must also be some doubt as to whether Defra would continue to fund the PFI credits, either at all or at the same levels, if the Council is in fact not delivering waste to the Facility which is part-funded by those PFI credits.

4.4. Each of the three options described above has the following in common:

- (a) significant obstacles to overcome in actually implementing the withdrawal from the Project Contract;
- (b) a high level of cost for the Council both in terms of finding an alternative solution/method for waste disposal in the interim until a new facility is provided and the compensatory payments it will be required to make to MVV and Devon County/Torbay; and
- (c) as existing waste disposal arrangements are not sustainable, an operational need to procure an alternative solution – which, even if some head-start is provided by the work done under the previous procurement, is still likely to be a relatively long process (with the additional expense that would entail), due to the need to run a new procurement process and obtain all necessary planning and regulatory consents.

4.5. In addition, the negotiated withdrawal option described above (which is highly unlikely), and the unilateral “withdrawal”, both have the effect of leaving the overall project substantially intact, with the consequence that construction of the Facility at North Yard can continue.

4.6. To summarise the above, it seems likely that the only way under the contract arrangements that would enable the Council to achieve the aim of halting construction of the Facility in North Yard would be for all other parties to agree a termination of the contract arrangements. We do not consider this to be a viable option.

## **5. Alternative Approaches – Re-Siting by Contract Variation**

5.1. The Project Contract contains a fairly standard mechanism allowing the Waste Partnership to require certain changes to the contract and its scope. We do not advise that this would provide a practical way forward due to the fundamental change in the nature of the contract and the likely resistance from the other contract partners.

## **6. Alternative Approaches – Termination of the Lease**

6.1. Clearly if the lease of the North Yard site between the MoD and MVV could legitimately be terminated, this would have the practical effect of halting construction of the Facility. We do not consider this to be a viable option, as the other parties would have no reasonable grounds to embark on that course of action. The lease provides valuable benefits for both parties.

## **7. Alternative Approaches – Pause to Re-Examine Alternatives**

7.1. We note that one of the main obstacles to the Council satisfying itself and the other Waste Partnership members that an alternatively sited solution would be preferable is the lack of any such concrete alternative.

7.2. The contract variation mechanism under the Project Contract could, in theory, be used to temporarily halt construction whilst alternative solutions are re-explored.

7.3. However, this would inevitably involve cost to MVV in terms of re-arranging its construction schedule (and associated sub-contracts), and cost to the other Waste Partnership members (and the Council itself) in terms of a delay to the point from which cheaper waste disposal can be accessed. The Project Contract's variation mechanism would require MVV to be compensated, and the other Waste Partnership members would almost certainly require the Council to cover such compensation in its entirety, as well as covering the costs to the other Waste Partnership members themselves.

7.4. Such a delay may also be sufficient grounds and motivation for Defra to withdraw the PFI credits, and again the other Waste Partnership members would almost certainly require the Council to make good such a financial loss if it materialised.

7.5. If a viable alternative solution is found, there would then almost certainly be a need to terminate the Project Contract, with the associated compensation on termination payment as described above. It is likely that the other Waste Partnership members would require the Council to cover most, if not all, of this payment to MVV.

7.6. Of course, there is also a realistic chance that no suitable alternative solution will be found, in which case the Council will have incurred substantial delay and considerable cost for nothing.

7.7. In summary, this approach would entail considerable expense for the Council, would require support from Devon County/Torbay, and has no guarantee that it will result in any better solution.

7.8. We advise that it is not a course of action that the Council can consider unilaterally and as such is not a viable proposition.

## 8. Conclusions

8.1. As stated in the Executive Summary above, a “withdrawal” from both the JWA and the Project Contract may be theoretically possible, but would be prohibitively expensive with levels of compensation that could exceed £400 million. Taking such a controversial decision about such a high-profile project also entails a real risk that one or more parties may seek to challenge the decision by way of judicial review. Accordingly, the reasons for such a decision need to be proportionate and robust based on reasonable consideration of the issues.

8.2 In reaching such a decision, the Council should have regard to the ‘Wednesbury test’ it is one of the tests used by the courts in deciding whether a decision by a local authority is proportionate and reasonable. The Wednesbury case (*Associated Provincial Picture Houses Ltd v Wednesbury Corporation (1948) 1 KB 22*) broadly said, that in coming to a decision, an authority:

- Must not take into account irrelevant considerations
- Must take into account relevant considerations
- Must not reach a decision that was so unreasonable that no reasonable authority would ever make such a decision

8.3 To set this in context, administrative decisions have been set aside where:-

- a decision is devoid of plausible justification; and
- where a decision-maker has made an erroneous finding of fact on a point that is fundamentally important in the case.

8.4 It is therefore crucial that if a decision to withdraw from the contractual arrangements is made, that it is made after consideration of the relevant issues and that the decision that is made is not irrational or unreasonable and based on sound judgement that is backed by robust evidence to support it.

8.5 If a decision were made to consider alternative waste disposal solutions, that would leave the Council susceptible to a challenge from one of the unsuccessful parties to the original procurement by means of judicial review , as well as the contractual claims that would arise from the existing contracting parties.

8.6 From our examination of the material there are no rational grounds to consider withdrawing from the current contractual arrangements. In the event the Council decides to withdraw from the current contractual arrangements, it is considered highly likely that an interested party will commence judicial review proceedings to challenge such a decision. Any decision by the Council to withdraw from the contractual arrangements will in our view be found to be unreasonable and unlawful.

**Foot Anstey LLP**

**16 August 2012**