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20 September 2021

Dear objectors

Gloucestershire County Council: audit of accounts 2016/17 – objection in respect of waste PFI contract – statement of reasons

This letter sets out the action we have decided it is appropriate for us to take in response to your objection to the accounts of Gloucestershire County Council (the Council) for the year ended 31 March 2017, in respect of the Private Finance Initiative (PFI) contract for the disposal of waste. We are sending it to you and to the Council in order to inform you of our decision and to set out our reasons.

The objection

We received your objection on 20 June 2017. You originally submitted it to us in April 2017, but as this was before the statutory period for making objections, we were unable to accept it at that stage and suggested you should resubmit it at the appropriate time.

You asked us to consider:

- producing a report in the public interest under schedule 7 of the Local Audit and Accountability Act 2014 (the 2014 Act)
- seeking a declaration from the court under s28 of the 2014 Act that there is an unlawful item of account.

Your concerns were essentially with regard to whether or not the PFI contract provides value for money (VfM), and incorporated a range of issues around the structure of the contract, underlying assumptions and the procurement process. Your specific concerns were that the contract:

- fails to achieve VfM/best value/economy and efficiency as required by law
- fails to achieve economic treatment of waste as high up the waste hierarchy as economically achievable as also required in law
- assumes insufficient improvement in recycling or waste reduction
- has a pricing structure that provides a very significant disincentive to recycle
- has termination costs that can be met by the capital already committed, and are significantly lower than was reported prior to the disclosure of the full contract

- is a form of long-term PFI contract, widely recognised as inflexible and expensive
- has hidden future costs because it is not in line with expected changes in regulation
- forecloses the opportunity for competition from new, improved technologies
- uses the inappropriate baseline of landfill as a comparator over 25 years
- over-predicts waste arisings and residual waste – more realistic lower figures will make the cost per tonne of waste in the contract much more expensive
- anticipates benefits that will only occur in ten years or more, based on projections which cannot be substantiated and therefore present high risk.

The Council's accounts for 2016/17 included a number of items related to the contract, most significantly the amount of £16.1m, being the 2016/17 element of the Council's contribution to the cost of the scheme, which was being accounted for as a pre-payment until the construction had been completed and the asset taken onto the Council's balance sheet.

You also referred in your objection to the complaint you had made to the Competition and Markets Authority (the Complaint) regarding the contract, alleging that the contract creates abuse of local market dominance to compromise competition, and in particular that the contract:

- Foreclosed alternative competitors and alternative technologies
- Distorted and prevented technological innovation.

We understand that the Complaint was submitted to the CMA on 21 March 2017 and at the same time, the Complainant provided a copy to both the Council and UBB. We also understand that the CMA has not yet made any contact with the Council following submission of the Complaint. In circumstances where the CMA, as the authority responsible for the regulation of competition within the UK, does not appear to be taking the Complaint forward in terms of investigation, we consider that it would not be proportionate for us to consider whether the contract creates abuse of local market dominance to compromise competition. Where we comment on issues that are the subject matter of your Complaint, we only do so to the extent that they impact on the VfM obtained by the Council, and not in relation to wider concerns around potential impacts on competition in markets for waste related services, as this would be for the CMA to determine.

You sought disclosure of certain documentation relating to the contract from the Council under the Freedom of Information Act 2000. In December 2018, the Council disclosed further information in relation to the contract with UBB, including various parts of the contract which had previously been redacted and a report by EY on Value for Money and Affordability Assessment dated 5 November 2015. In January 2019 you informed Grant Thornton that Community R4C Ltd ('CR4C') (an organisation with which you are associated) had commenced a civil action against the Council for breach of public procurement law in respect of amendments made to the contract with UBB in 2016. Following a hearing of two preliminary issues, the claim was dismissed by the High Court in July 2020 on the basis that CR4C did not have standing to bring a procurement law claim challenging the award of the 2016 contract, although the court held that the claim was not out of time (Community R4C Limited v Gloucestershire County Council [2020] EWHC 1803 (TCC) (QB)). CR4C appealed that decision and by an order dated 19 November 2020 the Court of Appeal refused permission to appeal.

In submissions and correspondence since December 2018, you have alleged that the expenditure on the PFI contract was not lawfully incurred because the amendments made in 2016 rendered the contract so different from the 2013 contract that it was effectively a new contract that was, contrary to procurement law, awarded to UBB without a competitive procurement process. You have also alleged that it follows that remuneration received by UBB under that contract constitutes unlawful State Aid (i.e. economic advantage provided to an economic entity in breach of the prohibition in Article 107(1) of the Treaty on the Functioning of the European Union ('TFEU')).

The Law

'Waste disposal authorities' are defined under s30 of the Environmental Protection Act 1990 and their duties are set out in s51:

51. It shall be the duty of each waste disposal authority to arrange -

- *a for the disposal of the controlled waste collected in its area by the waste collection authorities; and*
- *b for places to be provided at which persons resident in its area may deposit their household waste and for the disposal of waste so deposited.*

The 1990 Act also designates certain authorities as 'waste collection authorities', which are required to make arrangements for the collection of controlled waste and for delivering it to the waste disposal authority. In two-tier areas, district councils are waste collection authorities while county councils are waste disposal authorities.

Waste collection and disposal authorities are required under s32 of the Waste and Emissions Trading Act 2003 to work together to develop overall strategies for waste collection and disposal in their areas.

Regulation 12 of the Waste (England and Wales) Regulations 2011 requires waste collection and disposal authorities to apply the waste hierarchy when arranging for the disposal of waste:

12.—(1) An establishment or undertaking which imports, produces, collects, transports, recovers or disposes of waste, or which as a dealer or broker has control of waste must, on the transfer of waste, take all such measures available to it as are reasonable in the circumstances to apply the following waste hierarchy as a priority order –

- *a prevention;*
- *b preparing for re-use;*
- *c recycling;*
- *d other recovery (for example energy recovery);*
- *e disposal.*

2 But an establishment or undertaking may depart from the priority order in paragraph (1) so as to achieve the best overall environmental outcome where this is justified by life-cycle thinking on the overall impacts of the generation and management of the waste.

3 When considering the overall impacts mentioned in paragraph (2), the following considerations must be taken into account -

- *a the general environmental protection principles of precaution and sustainability;*
- *b technical feasibility and economic viability;*
- *c protection of resources;*
- *d the overall environmental, human health, economic and social impacts.*

Certain local authorities also have powers under the Town and Country Planning Act 1990 giving them separate status as 'waste planning authorities'. They are required to produce waste development plans and to determine planning applications relating to waste disposal. Waste planning authorities are in most cases also waste disposal authorities but they are required to separate these two separate roles. The waste development plans which they are required to produce are separate from the joint municipal waste strategies produced under the 2003 Act – the joint municipal waste strategy sets out overall plans for collecting and disposing of waste in an area, whereas a waste development plan deals with specific land use issues and forms the framework for assessment of waste-related planning applications.

We refer to further relevant provisions of the law in the sections below.

Background

Gloucestershire County Council is the waste disposal authority for its area, and also the waste planning authority. Collection of waste is the responsibility of the six district councils within the County.

In 2003, the Council began a procurement process for an integrated waste management contract, including disposing of residual waste (that part of the waste stream which remains after recyclable and reusable waste has been removed) and operation of landfill and household waste sites. £30.1m of PFI credits were awarded and bidders proposed the use of MBT (Mechanical and Biological Treatment) for treatment of residual waste. This process was halted in September 2005 because of concerns over the affordability of the contract and the extent of diversion of waste from landfill.

The Council recognised, however, that continuing to landfill residual waste was not a viable medium-term option, and in 2007 it commenced a further procurement exercise for a contract to deal with residual waste.

Key events in the development of this project are set out below:

July 2007	Cabinet approved purchase of land at Javelin Park, Haresfield.
November 2007	Cabinet approved the Residual Waste Procurement Plan for diversion of residual waste from landfill.
April 2008	Cabinet approves Outline Business Case for submission to DEFRA in order to obtain PFI credits for a long term waste contract.
July-August 2008	Public consultation and engagement on the project
November 2008	Cabinet approves the evaluation framework for a procurement exercise, using a competitive dialogue process.
January 2009	OJEU notice published in accordance with EU procurement regulations, announcing the Council's procurement intentions.
September 2009	Initial bids received from 8 bidders, with 11 separate bids (each bidder was allowed to submit two bids, allowing for different technologies).
December 2009	Cabinet approves four bidders to be invited to submit detailed solutions (ISDS)
October 2010	PFI credits withdrawn by DEFRA following national review of waste treatment capacity.
March 2011	Cabinet approves continuation of the project after review as a PFI. Two bidders from the four are invited to submit refined solutions.
July 2011	Bidders commence pre-application planning consultation with a view to applying for planning permission
December 2011	Urbaser Balfour Beatty (UBB) selected as preferred bidder

September 2012	Contract award to UBB approved
February 2013	Contract with UBB signed
March 2013	Planning permission refused
July 2013	Development 'called in' by Secretary of State following planning appeal by UBB
Nov 2013-Jan 2014	Public planning enquiry held
Jan 2015	Planning permission granted but challenged by Stroud District Council
August 2015	Final planning permission following dismissal of challenge.
November 2015	Contractor's Revised Project Plan approved by cabinet, reflecting increases in costs caused by delays in planning process.
February 2016	Contract amendment signed
May 2016	Final pre-construction planning condition discharged
Summer 2016	On site work commenced

Work we have carried out

We have:

- reviewed your written submission, including your follow-up email regarding Social Value and your submissions on interim issues;
- invited the Council to respond to your objection and reviewed their responses and supporting background information;
- shared the Council's response with you and invited you to make further comment;
- met with you to discuss and clarify your concerns;
- sought further explanations and information from the Council as necessary;
- considered the findings of the recent National Audit Office report on PFI;
- taken legal advice from specialist counsel on public procurement and State Aid and set out the key points within this document;
- considered whether the Judgement from CR4C's legal action against the Council impacts on our views
- shared with you those documents which we consider to be material to your objection;
- set out our provisional views on two separate occasions and invited comments on those provisional views from both yourselves and the Council, which we have considered; and
- ensured that you and the Council have had reasonable opportunity to comment on one another's points (at least where those points are ones that appear to us to be relevant to the matters we are making judgements about).

As part of your submissions, you have raised a considerable number of issues relating to the contract and/or to the Council's decision-making or governance processes in connection with the contract. We have considered your submissions but have also been mindful of the need to take a proportionate approach. We have a statutory audit function to perform, and it would not be proportionate and appropriate for us to venture beyond our remit so as to act as a 'general regulator' of the Council or to 'second-guess' its policy judgements or predictions for the future (e.g. as to how the costs of disposing of residual waste by landfill or other methods are likely to change over the long term). We also need to bear in mind that, just as the Council should steward its resources responsibly, we must consider proportionality when deciding whether it is appropriate for us to incur (or to ask the Council to incur) costs that would fall to be met from public funds.

Findings

We have set out below our consideration of issues raised by your objection.

Value for money

Your objection stated that the contract 'fails to achieve VfM/best value/economy and efficiency as required in law.' Many of your specific concerns dealt with in subsequent sections of this document relate to the 'VfM' of the contract, but this section covers your overall concerns in relation to VfM.

Before considering the VfM of the contract, it is important to emphasise that VfM is not an absolute concept and that it relates not only to cost (economy) but also to efficiency and effectiveness. Section 3 of the Local Government Act 1999 encompasses this by placing a duty on councils to achieve 'best value':

'A best value authority must make arrangements to secure continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness.'

Auditors are under a duty to assess councils' arrangements for ensuring economy, efficiency and effectiveness in the use of resources and to report this as part of each year's audit report. This VfM conclusion refers to the arrangements a council has in place for ensuring VfM, rather than being a judgement on the VfM actually achieved. Inadequacies in arrangements can sometimes be indicated or evidenced by an outcome that is demonstrably not VfM. This may warrant a public interest report. Equally there may be circumstances in which a failure to achieve VfM arises from or runs alongside an illegality, in which case, there may be an unlawful item of account in relation to which a declaration may be sought. It is not, however, the auditor's responsibility to 'second guess' the policy and operational decisions properly taken by councils in the exercise of their discretion, so any failure to achieve VfM would need to be extreme, or at least patent as well as being financially significant, for an auditor to intervene. It is moreover the arrangements in place that are the proper focus of auditors in relation to VfM. It is against this background that we have considered the VfM of the Council's waste contract.

With regard to the Council's arrangements for ensuring economy, efficiency and effectiveness in the use of its resources, we note that the Council's response to your objection comments extensively on the processes followed and how these should have ensured VfM at all stages. It highlights:

- Adherence to the requirements of the 'Green Book', which is guidance issued by HM Treasury on how to appraise policies, programmes and projects
- Adherence to EU procurement processes as embodied in the Public Contract Regulations 2015 (we discuss compliance with these Regulations further below)
- Use of a 'technology neutral' procurement process which enabled it to consider proposals for any closed loop solution offered by the market (see below in relation to the 'closed loop' restriction)
- Use of a model contract – SOPC4 - issued by HM Treasury and recommended for use by Defra under its Waste Infrastructure Delivery Programme – to ensure a reasonable allocation of risks between the Council and the contractor
- Employment of appropriate technical, finance and legal experts to assist with evaluation and negotiations.

The Council's ability to demonstrate its arrangements for securing VfM was, however, made more difficult by the delays in the project caused by the planning approvals process. The contract was signed in February 2013, before planning permission had been granted (see separate section below) and in the event it was another 28 months before satisfactory planning permission was obtained.

The contract as signed in February 2013 was drafted in anticipation of some delay between contract signature and the start of construction, and included various clauses setting out how key figures would vary in the event of delay. There was, however, a fixed price for the basic capital costs (known as the Engineering and Procurement Contractor – EPC – price) which applied provided that satisfactory planning permission was obtained by a 'long stop date' of 22 January 2015.

The contract provided that if satisfactory planning consent was not obtained by the long stop date, the Council would have the option of terminating the contract or asking UBB to provide a Revised Project Plan (RPP), to be agreed by the Council.

The Secretary of State's decision to allow the planning appeal and thus for planning permission to be granted was communicated to the Council on 6 January 2015, and therefore in advance of the longstop date. But this decision was challenged by Stroud DC and the planning permission was therefore not 'satisfactory' until that appeal had been dismissed in August 2015, by which time the longstop date had passed.

Schedule 26 of the contract, which is part of the SOPC4 template contract, sets out the matters which the draft RPP should cover, which include the revised costs for the delivery of the project. The contract requires that in preparing the draft RPP, UBB "shall be cognisant of procurement law, act in good faith and comply with Good Industry Practice with the objective of ensuring that it obtains best VfM for the Authority (taking into account all relevant circumstances including the requirement that [UBB] should be no worse off as a result of the implementation of the [RPP] and that the [RPP] ought to comply with all relevant Legislation) when procuring any works, services, supplies, materials or equipment required in relation to the revised Project". The contract also requires the Council and UBB to discuss and seek to agree each and every element of the draft RPP including "the provision of evidence that [UBB] has used reasonable endeavours (including (where practicable) the use of competitive quotes) to oblige its Sub-Contractors to minimise any increase in costs and maximise any reduction in costs" and "demonstrating how any Capital Expenditure to be incurred or avoided is being measured in a cost effective manner".

You have expressed concern that the complex negotiations which took place after contract signature, and which resulted in a significant variation in the total cost of the scheme, were not subject to competitive tension, as they were inevitably conducted with only one supplier. You referred to the comments made by the Council's financial advisors, in their 2015 report on the VfM of the project that 'given the stage of the Project, it is now more difficult to use the impact of competitive tension as a means of demonstrating VfM. The council has increasingly therefore focussed on a comparison of the cost of the PPP options against the continuing cost to dispose of waste through landfill.' In your note on the interim issues and subsequently, you have submitted that the modifications are a potential breach of procurement law and may have given rise to unlawful State Aid to UBB.

The documents disclosed by the Council in December 2018 show that the value of the contract signed in 2013 was circa £450m over 25 years (with an option to extend for a further 5 years). The 2016 Contract was for the same duration but the value of that contract was estimated by the Council to be £613m over 25 years. Whilst there appear to be some differences between the precise figures set out in different documents, it is clear that there was a significant change in the value of the contract.

The Council has emphasised that, in their view, the elements which could be changed between the original contract terms and the RPP were heavily prescribed within the contract, and there was no provision for an overall renegotiation of the contract. The Council submits that the main areas were 'fixed' in the sense that they were based on actual variations, e.g. the debt costs varied in accordance with the contractually committed costs incurred by the contractor. The main area where there was more flexibility was around the variation in the EPC, and this was agreed through negotiations around cost trends between the Council's quantity surveyors and other advisors and those employed by the contractor.

The Council was supported by its technical, financial and legal advisers and there were negotiations over a period of several months. The Council submits there was no significant change in the risk allocation position as a result of these negotiations.

The Council has confirmed that the proposed contract, including the RPP procedure, was shared with all the tenderers at the ISOS (Invitation to Submit Outline Solution) stage, and they were required to acknowledge this as part of the bid submission process. It was also subsequently shared with them at the ISRS (Refined Solution) stage.

The Council says that it has satisfied itself that the RPP reflects best VfM in accordance with paragraph 3.3.2 of Schedule 26 and that the process envisaged in paragraphs 3.3.4 – 3.3.6 of Schedule 26 has been followed. The Council considers that these clauses satisfy the requirements of regulation 72(1)(a) Public Contracts Regulations 2015, on the basis that these clauses are "clear, precise and unequivocal review clauses" which:

i *"state the scope and nature of possible modifications or options as well as the conditions under which they may be used"; and*

ii *"do not provide for modifications or options that would alter the overall nature of the contract".*

The Council notes that the outcome of the negotiation process was then tested through EY's November 2015 VfM assessment which compared the NPV of the RPP (based on the latest iteration of the contractor's financial model) with an option of terminating the contract and continuing with landfill (see specific section below). The Council further submits that the figures in the final signed RPP (i.e. the RPP as modified as the outcome of the negotiations) did not vary significantly from those used in this evaluation – the NPV of the project reduced by around £5m between this version of the model and that supporting the final RPP.

In the High Court public procurement proceedings the Council also placed reliance, in the alternative to regulation 72(1)(a), on regulation 72(1)(e) of the PCR 2015 which permits modifications, irrespective of their value, provided that they are "not substantial" within the meaning of regulation 72(8).

We consider that there are three issues to be considered: (i) whether the Council had satisfactory arrangements in place for ensuring economy, efficiency and effectiveness in the use of its resources; (ii) whether the amendments to the contract were lawful or in breach of public procurement law; and (iii) whether the Council secured actual VfM.

In our view, these are separate questions from one another, in the sense that different answers may be given to each of them. While the Council relies on compliance with public procurement law as part of its arrangements for ensuring economy, efficiency and effectiveness, it only forms part of its arrangements. In our view, a finding of a breach of public procurement law should not per se necessarily result in a finding that the Council did not have satisfactory arrangements in place for ensuring economy, efficiency and effectiveness or that it failed to secure VfM.

We expressed this view to you as part of our provisional views and we understand you disagree with us on this point. You have submitted that the purposes of public procurement law include ensuring that public authorities obtain VfM when purchasing, and that it follows that VfM is unlikely to have been obtained in circumstances where a council has agreed modifications to the terms of a contract incompatibly with procurement law.

We agree with you that compliance with public procurement law is, in general, likely to ensure that a council achieves VfM and can demonstrate this. In our view, however, it is, in the present case, necessary to consider the particular sets of circumstances that the Council faced at the times when relevant decisions were taken. The decision taken by the Council to agree the terms of the final RPP recorded in the 2016 Contract was taken in circumstances where the Council was already bound by the original contract (i.e. the 2013 Contract), and the alternative to agreeing modified terms with UBB would have been to terminate the contract. Termination of the contract would have triggered an obligation under the contract to pay termination costs to UBB and could also have given rise to other costs for the Council, including landfill costs and the costs of conducting a new procurement process. There may also have been a risk that a new procurement process would have resulted in an outcome involving higher costs for the Council for dealing with residual waste. All these potential costs might reasonably

have been regarded by the Council as relevant to whether the decision it took to agree the final RPP was an economically efficient choice to make, given the alternatives – albeit that, as a matter of procurement law, a desire to reduce the overall cost to the Council is not, of course, a justification for breaching procurement law.

Procurement law pursues objectives that are wider than promoting the efficient use of public resources. In particular, procurement law, as applicable at the relevant time, sought to pursue EU internal market objectives and to ensure the compliance of EU member states with obligations under the World Trade Organisation Global Procurement Agreement, by ensuring that contract opportunities were opened up to competition and that public procurement procedures were non-discriminatory and transparent. In some circumstances, public procurement law could potentially operate to preclude an authority from selecting an approach which could reasonably be regarded by the authority as the most economically efficient option available to it in the circumstances.

In making this point, we do not suggest that a council's breach of procurement law is excusable or unimportant provided that the council thinks it is achieving VfM. Our point is that our function as auditor is to consider whether the Council had satisfactory arrangements in place for securing VfM, and not to act as a general regulator of the Council in relation to its compliance with public procurement law.

We recognise that you also criticise the original contract, the terms of which resulted in the position in which the Council found itself after the longstop date of 22 January 2015 had passed due to the planning process having taken longer than the Council had expected. In our view, however, it is important to recognise that the Council has a margin of discretion when deciding the terms on which it will enter into a contract, and the Council's judgements in taking such decisions should be assessed on the basis of the facts known at the time, rather than with the benefit of hindsight. Whilst the Council could, for example, have specified a later longstop date in the original contract, this could have had an impact on the prices and other terms that bidders were willing to offer.

In circumstances where an authority has bound itself to contractual obligations relating to a possible future scenario (such as failure to obtain a satisfactory planning permission by a particular date), the subsequent occurrence of that scenario may affect the options available to the authority at that point in time. In those circumstances, the authority will have to assess the VfM of the various courses of action that are available to it at that time, taking the circumstances as they are at that time, including the fact that it is already bound by the obligations it assumed.

Did the Council have satisfactory arrangements in place for ensuring economy, efficiency and effectiveness in the use of its resources?

In our view, the approach taken by the Council in 2015 and 2016 for negotiating and agreeing the RPP and 2016 Contract was not inconsistent with the Council having had arrangements in place for ensuring economy, efficiency and effectiveness in the use of its resources and we have concluded that those arrangements were satisfactory. As explained above, the Council was assisted by EY and other external advisers when it scrutinised UBB's draft RPP including the proposed inflation-related adjustments to the EPC. The Council assessed whether the option of agreeing the terms in the RPP and the 2016 Contract represented the choice that was overall an efficient one for it to make, compared with the alternative of terminating the contract.

We agree that the competitive tension was lessened during the RPP negotiation process, given that there were no other bidders in the frame at that stage, and the Council's available alternatives to agreeing an RPP with UBB would involve significant costs. However, the Council was professionally advised during the negotiation process, including by EY on the VfM of the RPP in comparison to terminating the contract and relying on landfill. In terms of VfM, the Council had limited options at this stage, having signed the 2013 Contract – any other options to negotiating an RPP would have required incurring expenditure on termination of the contract and either continuing to landfill residual waste or starting a completely new procurement process for an EfW or other technology solution, thus introducing further long delays, presumably with continuing reliance on landfill until the new solution was operational. Further, the Council submits that, in terms of the possibility of a new procurement, it was concerned it might not generate sufficient take-up as this would have been its third attempt to procure the service. Any alternative, therefore, would have entailed significant termination and new procurement

costs. The Council made a capital contribution in order to bring the cost within the affordability limit sooner than would be possible without the capital contribution.

Was the Council's agreement of the 2016 Contract compatible with procurement law?

We consider that the conditions set out at para 3.2.2 of Schedule 26 to the 2013 Contract applied on the longstop date of 22 January 2015 and that the Council was therefore obliged under the last part of section 3.2 either to terminate the contract or to ask the contractor to provide a draft RPP. Paragraph 3.3 of Schedule 26 set out provisions governing UBB's preparation of a draft RPP and the subsequent potential agreement of an RPP between UBB and the Council.

The Annex to this letter sets out a summary of submissions made to us by the Council and yourselves, and the independent legal advice we have received from specialist counsel, as to whether the Council's agreement of the 2016 Contract was compatible with procurement law. Your position is essentially that the modifications to the contract which were agreed in 2016 went beyond what was permissible under procurement law and thus constituted, for the purposes of procurement law, the unlawful award of a new contract without a competitive process.

Our view, in line with the advice we have received from independent Counsel, is that the material we have so far considered is insufficient to enable us to reach a firm conclusion as to the lawfulness under procurement law of the modifications. In that regard:

a Paragraph 3.3 of Schedule 26 does not suffice to constitute a "clear, precise and unequivocal review clause" so that modifications made by way of an RPP could be considered compatible with procurement law without the need to consider whether those modifications change the economic balance of the contract in the contractor's favour. Notwithstanding the Council's submissions that the modifications that could be agreed by way of an RPP were heavily prescribed by the terms of the 2013 Contract, paragraph 3.3 of Schedule 26 is framed in apparently broad terms and could (at least absent constraint from procurement law) permit extensive modifications to the project plan, allocations of risk, and/or remuneration. That is so even though clause 3.3 provided that UBB should, in preparing the draft RPP, "be cognisant of procurement law, act in good faith and comply with Good Industry Practice with the objective of ensuring that it obtains best value for the Authority … when procuring any works, services, supplies, materials or equipment", and that the Council and UBB must discuss and seek to agree various matters including provision of evidence showing that UBB had used reasonable endeavours to oblige its Sub Contractors to minimise cost increases. These general principles do not determine the price increases and other modifications to be made, and they appear still to leave broad scope for changes to the contract to be negotiated. No mechanism is prescribed for determining the amount of additional remuneration UBB should receive based on demonstrated changes in its likely costs and/or modifications of the project plan.

b Thus, the modifications agreed in 2016 by way of the RPP would be compatible with procurement law only if, seen as a whole, they did not change the economic balance of the contract in UBB's favour.

c The material we have considered does not suffice to enable us to reach a firm conclusion on whether the economic balance was so changed, albeit there are some indications that it may have been.

Counsel has further advised us that, in order for us now to assess whether the economic balance of the contract was changed in UBB's favour, we would need to undertake or commission a detailed investigation that examined and tested the specific reasons and justifications for the various changes, and then sought to assess the effects of those changes on the economic balance of the contract. Such an investigation would involve us having effectively to reconstruct the Council's internal processes by which it scrutinised the draft RPP with the assistance of external advisers, but with the specific focus being on whether the various changes, seen as a package, shifted the economic balance of the contract (and, if so, in whose favour), rather than on comparing the costs of the package as compared with the alternative of terminating the contract.

Such an investigation would be an expensive and difficult exercise, especially given the considerable time that has passed since 2016. It may not be possible to reassemble all the relevant material that was available to the Council at that time. Internal personnel and external advisers who were involved in the process of challenging, and negotiating over, UBB's draft RPP may no longer be available to assist with the exercise; and even if they were, their recollections will have faded. Consultants from a variety of disciplines might need to be engaged for carrying out the investigation, which would involve substantial costs.

Even if such an investigation were undertaken, it might not enable us to reach a clear conclusion as to whether the contract modifications were compatible with procurement law. Given the difficulties of carrying out the investigation, there would be a substantial risk that the investigation would not produce a positive conclusion one way or the other. This is a material factor we need to consider when deciding whether it would be proportionate to carry out such an investigation, the costs of which would be borne by local taxpayers and would reduce the resources available for funding local services.

You have submitted that there can be no doubt that the modifications shifted the economic balance of the contract in favour of UBB, since there was a significant increase in the costs to the Council of the 2016 Contract as compared with the 2013 Contract, which was substantially in excess of relevant prevailing rates of inflation over the intervening period. We see the force in that point. As the Council has pointed out, however, it was an aspect of the 2013 Contract terms that, in the event of a planning delay going beyond the longstop date, the contractor could no longer be held to the original contract terms, since costs and other assumptions underlying the original project plan would become increasingly unreliable with the passage of time. The provision for a draft RPP to be prepared by UBB, and for an RPP potentially to be agreed by the Council, in those circumstances was an opportunity for inter alia changes in UBB's projected costs to be adjusted for. The changes in costs of the project may not be fully or adequately captured by a prevailing rate of inflation applicable to, for example, infrastructure projects generally, and the costs are not purely arising from inflation – they include significant additional costs which flow directly from the delays – for example UBB having to service debt which it has secured in advance of need. In our view, the material we have received, and the enquiries and analysis we have carried out, do not suffice to enable us to conclude that the various changes to the contract, seen as a package, shifted the economic balance of the contract in UBB's favour.

We also note the Council's observation that it had visibility of UBB's financial model, and that a comparison of the Base Case Equity Internal Rate of Return (IRR) between 2013 and 2016 shows that UBB's projected return fell from 12% to 10.77% (both real). On that basis the Council submits that, if the economic balance of the contract changed, it changed in favour of the Council. We emphasise, however, that we make no finding as to whether this comparison constitutes persuasive evidence in support of that conclusion. We have not ourselves tested those percentages, which would require us to assess the robustness of the underlying cost projections – an exercise that we consider would be disproportionate, for the reasons already given above. Further, even if it was reasonable to assess the changes to the contract, seen as a whole, as not increasing UBB's expected IRR, this may not suffice in itself to demonstrate that the changes did not move the economic balance of the contract in UBB's favour: for example, there could still have been changes in how certain risks were allocated which would tend to favour UBB in certain scenarios not captured by the Base Case IRR projection.

You have pointed us to other evidence which you say supports a conclusion that the economic balance changed in favour of UBB. For example, you say that the gate fee cost per tonne in 2019/20 was much higher than the industry average, and that, if contract termination costs are excluded, the 2016 Contract is more expensive than landfill. In our view, however, such comparisons are of limited utility for showing that the contract terms shifted in UBB's favour. That is because comparisons between costs actually incurred by different councils and/or under different contracts can provide only limited insight for assessing the economic value to the contractor of a set of changes in contract terms within a single contract, especially given that the contract is of long duration and the prevailing average costs to local authorities of particular alternative waste disposal options may fluctuate significantly over the course of that long period of time.

You have also placed reliance on an oral observation you say was made by the Council's Chief Executive at a meeting of the Overview Scrutiny Management (OSM) Committee meeting on 22 March 2019 observing that half of the increase in the projected costs of the project to the Council related to the fact that the contractor was in an advantageous position. In our view, even assuming that such a statement was made by the Chief Executive (and we make no finding as to whether it was: we note that the Council does not accept that your record of the meeting is accurate), it would not in itself justify our making a finding that the contract modifications shifted the balance of the contract in UBB's favour. Any such finding would need to be made based on an objective appraisal of the modifications and of how they affected the overall economic balance of the contract, not simply on a single remark made orally by the Chief Executive.

Against this background, we have considered whether it would be proportionate for us to commit further resources to enquiring into the compatibility of the contract modifications with procurement law, with a view to determining whether procurement law was breached. Taking account of all of the circumstances, and as noted above, we have decided that it would not be proportionate. The exercise would require a time-consuming, complex and expensive investigation, and even if a great deal of time and money were expended, it might fail to produce a clear conclusion. The costs of such an exercise would be carried by local electors and could divert funding away from other public services. Whilst we recognise that the contract was for a long-term arrangement of particularly high value, we also bear in mind that it is one contract and was entered into in a certain set of circumstances a considerable time ago.

Even if we were able, at the conclusion of such an investigation, to find, on the balance of probabilities, that there had been a breach of procurement law, there is no obvious mechanism by which such a finding could then lead to the contract (which incorporates the modifications made by way of the 2016 Contract) being invalidated, or to the Council otherwise being relieved of its obligations under the contract. Whilst the High Court has power to make a 'declaration of ineffectiveness' where a contract has been materially changed in circumstances where this was impermissible under procurement law, the time limit for anyone to seek such a remedy has long passed. The fact that a public authority has entered into a contract in circumstances involving a breach of procurement law does not, as a matter of law, automatically render the contract invalid or mean that the authority is not legally obliged to honour the terms of the contract.

The benefits to local electors of enquiring into the compatibility of the modifications to this contract with procurement law may therefore be limited. We have not seen evidence that suggests that there may be a pattern of non-compliance with procurement law by the Council.

Further, we bear in mind that, whilst allegations of an individual breach of procurement law can be pursued by way of court proceedings, the auditor is not required to make determinations as to whether any allegation of breach of procurement law by a council is well-founded. The auditor's functions and remit are concerned with whether the authority's activities generally are consistent with the responsible stewardship of public funds, whereas it is principally for the courts to rule on disputes about whether procurement law has been breached in relation to the process by which a particular contract came to be awarded.

You argue in your letter of 22 January 2021 that it is not up to us to decide whether to carry out further investigation for seeking to determine whether procurement law was breached, and that this decision should be taken by the Council's Audit and Governance Committee. You urge us to instead set out "the pros and cons of undertaking further analysis" to inform the taking of that decision by the Committee. In our view, however, our role requires us to ourselves determine whether it is appropriate for us to carry out further work in order to properly discharge our responsibilities as auditor.

You have made the point in your submissions dated 25 January 2021 that the Council is obliged under section 3 of the 2014 Act to keep adequate accounting records but it does not appear to have carried out analysis in 2016 of whether the package of contract modifications changed the economic balance of the contract in UBB's favour. Our views on this point are as follows:

a The Council's assessment of the draft RPP was focused on whether it offered VfM as compared with the alternative of terminating the contract. It appears that the Council did not make a

contemporaneous assessment of whether the package of modifications changed the economic balance of the contract and, if so, in which party's favour, when agreeing those modifications.

b It would have been appropriate for the Council to have carried out such an assessment in order to ensure that its agreement to the modifications was compatible with procurement law.

c The Council's failure to make that assessment is explicable by its legal view that no such assessment was required since paragraph 3.3 of Schedule 26 constituted a "clear, precise and unequivocal review clause" so that modifications made in accordance with that section would be compatible with procurement law on that basis. As set out above, however, we disagree with the Council's legal view on this point.

d In all the circumstances, the Council's failure to make and record such an assessment is not in itself a breach of its obligation under section 3 of the 2014 Act to keep adequate accounting records.

From an audit perspective, a decision making process followed by a council which accorded with its legal view at the time is not in itself necessarily a cause for concern simply because that legal view may have been erroneous. Such a process does not necessarily indicate that the council lacks appropriate internal procedures for ensuring the sound management of its resources.

In relation to your concerns regarding State Aid, we note that those concerns are essentially based upon your allegation that the contract modifications agreed in 2016 were incompatible with procurement law and thus constituted the awarding of a new contract without a competitive process. You say that the shifting of the economic balance of the contract in UBB's favour means that the remuneration it thereby obtained the contractual right or ability to receive from the Council exceeds market terms as identified through a competitive process. Given that we have not reached any conclusion as to whether the modifications shifted the balance of the contract in UBB's favour, we likewise do not go on to make a finding as to whether the modified contract conferred unlawful State Aid.

For the sake of completeness, however, we note that, even if we had found that the 2016 modifications shifted the economic balance of the contract in UBB's favour and were incompatible with procurement law, it would not automatically follow that UBB has received unlawful State Aid. In that regard, we note that the advice we received from independent specialist Counsel regarding the relevant principles of State Aid law (as applicable in 2016, at which time the United Kingdom was still a Member State of the European Union) is, in summary, as follows:

i Market rate remuneration paid by the State to an economic entity in consideration for goods or services supplied to the State by that entity does not constitute an "economic advantage". Where, however, the State pays remuneration which exceeds market rate remuneration, then this is in principle likely to constitute an "economic advantage".

ii Amounts of remuneration paid by the State to an economic undertaking will be assumed to be consistent with market rates in circumstances where those amounts are payable under a contract awarded by a competitive process capable of identifying the person willing to provide the required goods or services at the lowest efficient cost to the purchasing authority. Remuneration that is contractually due under the terms of a contract awarded by means of a competition conducted in accordance with the PCR 2015 (or its predecessor, the Public Contracts Regulations 2006) will therefore not constitute State Aid.

iii Where, however, a contract has not been awarded using a competitive process, there is the potential for the remuneration paid under that contract to be greater than the market rate. The same is true where, as may be the case here, the terms of an awarded contract are materially altered during the contract term in a manner which was not permitted by procurement law, and is therefore regarded by procurement law as amounting to the unlawful direct award of a new contract.

iv This does not mean, however, that remuneration paid under such a contract can simply be assumed to exceed market rate remuneration and to give rise to State Aid. Whether remuneration being paid under a contract exceeds market rate remuneration is essentially a question of fact, to be established by evidence.

v Accordingly, a finding that remuneration paid under a contract amounts to State Aid cannot properly be justified by reasoning that "the contract terms have been altered by unlawful modification; q.e.d. the remuneration must be exceeding market rate remuneration and must therefore be conferring an economic advantage". On the other hand, it is possible to draw reasonable inferences from the circumstances.

vi The case-law of the EU Court of Justice suggests that the drawing of an inference that an economic advantage is being provided may be appropriate in circumstances where the State is remunerating a supplier at rates that have not been determined through a competition or other process capable of identifying the market price. But the Court has not gone as far as saying that any remuneration at rates that have not been determined through a competitive process, or which are paid under a contract that has been unlawfully modified, are to be assumed to confer an economic advantage on the recipients of such remuneration.

vii In addition, in the present case, the counterfactual situation is not that the original contract would have continued, but rather that it would probably have terminated (with UBB then receiving the Force Majeure Termination Sum). UBB was not contractually obliged to deliver the project in exchange for the same, or similar, amount of remuneration as provided for in the 2013 contract. Following such termination, the Council would have needed to award a different contract, potentially similar to the 2016 Contract, through a new competitive process. It is not possible to know whether the price and other terms that the Council would have been able to secure through such a competition would have been better or worse than the terms that the Council agreed with UBB by way of the RPP and 2016 contract. Accordingly, it would not be safe to rely on the economic balance encapsulated in the 2013 Contract as a reliable benchmark against which to assess whether the terms of the 2016 Contract were favourable to UBB, as compared with the terms of a (hypothetical) equivalent contract awarded in 2016 using a competitive process.

viii Further, UBB and the Council may have a reasonable argument that the terms of the 2016 Contract did not truly confer an "economic advantage" on UBB because, even if those terms were more favourable to UBB than the terms of a (hypothetical) equivalent contract awarded in 2016 using a competitive process, those terms were nevertheless the consequence of the ordinary operation of the market. In that regard, the Council and UBB could refer to the "market economy operator principle" under which the State will not be found to be providing State Aid where it acts in the same way as a (hypothetical) commercially-motivated operator would have been prepared to act in its own interests in comparable circumstances. A commercially-motivated person who was the purchaser party to a contract under which he was required to pay the supplier party the "Force Majeure Termination Fee" might well be willing to make a deal with the supplier-party to avoid having to pay that fee, even if that deal involved paying more under the modified contract than the "market rate price" that he could potentially have accessed by awarding a new contract through a competitive process. The commercially-motivated purchaser would choose the option which was most economically efficient for him overall.

ix It is extremely rare for a finding by a court in England that a public contract that has been awarded and entered into, or has been modified, unlawfully to lead to a subsequent claim or finding that the supplier-party to that contract has received unlawful State Aid. A major reason for that rarity is the difficulties of demonstrating that the remuneration paid under the contract actually exceeded market rate remuneration and thus constituted an economic advantage to the contractor.

We note that you have told us that you have made a complaint to the European Commission alleging that the 2016 Contract has given rise to unlawful State Aid. The investigation of that complaint is a matter for the European Commission.

Did the Council secure actual VfM?

In terms of the actual VfM of the project, demonstrating VfM on a major contract such as this is complex and there are at least two approaches:

- Demonstrating that the outcome of the process provides VfM through comparisons of predicated or actual outcomes against empirical data (for example, in this case comparing the gate fee per tonne against that achieved by other waste disposal contracts)
- Demonstrating that a sound process for procuring the service has been followed, which has ensured that competitive pressure leads to a VfM outcome. This of course relies not only on the procurement process itself but on what precedes it in terms of options appraisal, business cases and specification.

You have raised concerns which relate to both of these approaches. We have already addressed the procurement process above: our view is that the competitive pressure was lessened during the RPP process, but that the Council took a number of steps to seek to ensure that the outcome represented VfM and it would not be proportionate for us to seek to determine whether there has been a breach of procurement law.

You have provided comparative figures on gate fees from the published WRAP gate fee report for 2014/15, which was current at the time of the final VfM evaluation. For EfW, this shows that the median gate fee for post-2000 facilities was £99, with a range between £65 and £132. For MBT/MHT, the median is £88, with a range from £68 to £107.

In your original objection, you also provided current spot rates for a range of reasonably accessible EfW plants which had surplus capacity at that time. All but one of these was in the range of £101 to £121 including transfer costs. You concluded that, despite being a spot rate rather than the rate from a long term contract, these costs were all less than the cost of £132 you had calculated for the contract. You therefore argued that the latter could not represent VfM.

In response to our queries on this particular point, the Council stated that:

'The philosophy they use of simply quoting a single gate fee is also fraught with error for the following reasons: perhaps best summed up by the WRAP report and I quote "it should be noted that long-term local authority contracts procured through PFI or PPP can be structured quite differently from other contracts, and therefore, such gate fees may not be directly comparable". We maintain our view that;

- *It is competition that generates VfM and the prices we saw in competition reflect those that the market offered.*
- *We don't know how risks are allocated in these gates fees quoted (between a LA and a contractor) and this can have a significant impact on the real price.*
- *The gate fee is only at a point in time. To look at this over the 25 year contract to calculate VfM you would need to know how the inflation clause is dealt with in the contract and the contracted tonnages. i.e Value for Money has to be calculated on a whole of life basis not a single point.*
- *Although the WRAP information on local authority EfW contracts contains many examples of long-term agreements (approximately 40% being 25 years in length or longer) 60% are for short term contracts where cost increase will be passed on in full. Prices on these contracts are likely to be lower than a 25 year anchor contract as the Local Authority has no guarantee that this capacity will be available in the medium term. Hence it a is not a truly valid comparison to a single 25 year contract*
- *The WRAP report does not differentiate between the size of facilities. Obviously the larger the facility the cheaper it is to treat waste. Gloucestershire is in waste terms geographically isolated and hence is one of the smaller facilities which does give a cost premium but this is at a saving in terms of transport cost and environmental impact.'*

The Council also notes that, of the ten comparison sites used in your comparison of spot rates, six of them are operated by bidders who bid for the Gloucestershire contract and were rejected on grounds of either price or quality.

We accept that the comparisons included in the WRAP report do have significant limitations, mainly because they are, as the Council notes, quoted at a point in time and in isolation from the underlying contractual terms such as length of contract, risk share etc. Without access to such information on the contracts in place elsewhere, it is impossible to do a conclusive comparison, and even with full information on the various contracts, there would still be a good many judgements and assumptions involved in making a comparison because of, for example, variations in the 'values' associated with particular risks.

The Council has also suggested that the average gate fee of £132 per tonne which you have used as the basis of your comparisons is overstated, pointing out that it does not use an indexation calculation that is in accordance with the contract, nor does it appear to discount later years using the government discount rate. It is not, therefore, in the Council's view, a valid comparator.

We accept that indexation and discounting are needed in order to carry out a valid comparison of costs over the whole life of the contract, but as noted above, this would not in any case be possible if the only comparators are the prices in the WRAP reports, as these do not reflect the whole life of the contract.

Overall, but noting that we have addressed your more specific concerns in the sections which follow, in our view the Council has followed appropriate processes in entering into the contract for the EfW plant and put in place sufficient arrangements to assess VfM. It used an open tendering process to appoint the preferred bidder in the first instance, following the relevant guidance and putting in place a contract which shared risks in the normal way between the Council and the contractor. In our view, it also, in negotiating the RPP, took reasonable steps for satisfying itself that it was obtaining VfM in the circumstances. While this negotiation process was not subject to direct competitive tension, the Council took advice from appropriate sources in relation to the negotiations. It is difficult to conclude from available empirical data whether the modified contract actually achieves good VfM in terms of gate fee per ton compared with that achieved by other authorities (and disposal methods).

You have questioned some of the assumptions and projections EY and/or the Council made when assessing the VfM of agreeing the RPP as compared with an alternative of terminating the contract. In that regard, you submit, for example, in your submission of 25 January 2021, that the Council's estimate that it could cost £40m to carry out a new procurement process is "outrageous" since the Council could have procured short-term contracts with existing residual waste providers, and the procurement costs of this approach would have been much less. In our view, however, it was for the Council to consider how best to meet its future requirements for dealing with residual waste, albeit within the parameters of its legal duties.

In our view, in circumstances where we are satisfied that the Council made appropriate arrangements for ensuring VfM (this being the focus of the auditor's role in relation to VfM), including to some extent seeking expert advice from EY on the VfM of the RPP, it would not be proportionate for us to undertake the further analysis of the actual VfM of the RPP, given that this would involve seeking further expert advice, the costs of which would have to be borne by local taxpayers.

The EY report appears to have provided some assurance to the Council with regard to VfM, although in our view, it was of limited use given the comparison to only landfill (see below however for our view on the appropriateness of any alternative comparators).

Waste hierarchy

Your objection stated that the contract 'fails to achieve economic treatment of waste as high up the waste hierarchy as economically viable as also required in law.' As noted above, the legal framework for the waste hierarchy is set out in the Waste (England and Wales) Regulations 2011, which imposes on the Council a duty to seek to reuse and recycle waste in preference to "other recovery" (such as incineration with energy recovery) and, last of all, disposal by landfill or by incineration without energy recovery. You also point out that methods such as Mechanical Biological Treatment (MBT) are higher up the hierarchy than incineration.

In its response to your objection, the Council has indicated that it is not 'required' to achieve treatment as high up the hierarchy as possible, and instead quotes from the 2011 DEFRA Waste Policy Review and a further DEFRA publication from 2014, 'Energy from Waste. A guide to the debate.' While the

review clearly states that it is guided by the waste hierarchy, it sets out the wider context and a wider range of actions and targets. The Council has pointed out that its Joint Municipal Waste Management Strategy (JMWMS) sets out an overall approach which incorporates recycling targets in excess of the DEFRA targets and in which Energy from Waste forms an integral part of the overall strategy for diverting waste from landfill in accordance with the waste hierarchy.

In our view, the 2011 Regulations do place a specific requirement on the Council to take all such measures as are available to it to apply the waste hierarchy, but only as are 'reasonable in the circumstances' and they may depart from the hierarchy in order to achieve the best overall environmental outcome where this is justified by life-cycle thinking on the overall impacts of the generation and management of the waste. In considering the overall impacts, the Council is entitled to take into account technical and economic feasibility. In our view, there is thus not a requirement for strict adherence to the waste hierarchy as the sole determinant of waste strategy, but the Council needs to act in accordance with the 2011 Regulations.

The way the Council does this is set out in the JWMMS as well as in the Council's response to your objection, which states that:

- EfW needs to be seen alongside the priority given by the Council to kerbside collection, which reduces residual waste (and is clearly in accordance with the hierarchy)
- EfW provides energy security for the Council in the form of renewable energy
- The Council has considered but dismissed further separation of recyclates from the residual waste stream because of the costs involved and the uncertainties in the recyclates market.

In our view, these are all legitimate considerations for the Council in complying with the 2011 Regulations with regard to the waste hierarchy, and we do not consider that the Council's approach, including the contract, is divergent from the Regulations.

In your submissions of 25 January 2021 you argue that there is "mounting evidence that waste incineration is (or will soon be) on a par with landfill in terms of CO2 emissions". In our view, however, it is not our role to opine on the extent to which EfW incineration is preferable to landfill in terms of climate change impacts. As noted above, the waste hierarchy places EfW incineration above landfill.

Assumptions

Your objection stated that the contract 'assumes insufficient improvement in recycling or waste reduction' and 'over-predicts waste arisings and residual waste'. You stated that:

- the Council has consistently over-predicted total household waste arisings, with municipal solid waste rising by 1.4% since 2019/10 compared with the 6.4% increase envisaged when entering into the contract
- the Council has assumed that residual waste will grow at 2% per annum from 2030 onwards, thereby bringing down the average gate fee paid, but that this forecast is unsubstantiated and in excess of any independent forecasts
- the contract is also based on relatively low recycling rates, and that better performance would lead to reductions in residual waste, increasing the average price per ton of the contract and making it worse VfM.

The Council, in its response to your objection, denies any over prediction of waste arisings and residual waste forecasts. It points out that its waste predictions were rigorously tested during the production of the Waste Core Strategy in 2010/11 and the subsequent public enquiry in 2012. The inspector determined that the Council had used a set of assumptions that were considered 'likely to be of the right order' and 'based upon an analysis of locally derived data in the context of knowledge about local circumstances.'

In relation to recycling rates, the Council's response states that, for the County as a whole, the assumed levels of recycling will require ambitious increases in performance, while acknowledging that there is a wide range of factors which are likely to impact on recycling rates which means that it is difficult to

predict residual waste trends with any certainty. The Council also suggests, while not accepting that it has done so, that it is better to over- than under-predict residual waste, because of the risk of having too little capacity and thus having to resort to landfill.

Predictions of residual waste volumes are complex, depending on a wide range of factors such as economic conditions, recycling rates, developments in the packaging of goods, consumer behaviour etc. As external auditors, we can only review the processes followed and not 'second guess' the actual predictions. A key part of the process appears to us to be the Core Strategy enquiry, as referred to in the Council's response. Our review of the enquiry report demonstrates that the Council's assumptions were rigorously tested by the inspector, who made recommendations for some limited further revisions, and that many of the issues which he considered in the course of the enquiry were similar to those you have raised with us eg the 'conservative' predictions on recycling rates. Given that this was a statutory process carried out by an expert, we see no reason to challenge the outputs from this process as the basis for predicting the residual waste to be handled in the EfW contract.

The outcome of the Core Strategy process in this regard was that the Council needed to make provision for the disposal of up to 145,000 tonnes of residual waste per annum in the plan period up to 2027, with a minimum expected volume, which accords with the pricing structure in the contract.

We note that while some of your concerns relate to the same issues as considered in the Core Strategy process, others relate to trends in waste arisings since then. You comment particularly that actual waste arisings since the base year for the contract have increased by only 1.4% as opposed to the predicted 6.4%. You also point out that the waste volumes assumed for the contract, which goes beyond the period covered by the Core Strategy, assume year-on-year rises of 2% per annum from 2030 onwards. This prediction clearly has an impact on the average gate fee per tonne and hence on the VfM of the contract.

In relation to trends since the Core Strategy Review and contract close, the Council has provided the following figures for tonnage of municipal residual waste:

Year	**Tonnage**	**% Change**
2012/13	144,822	n/a
2013/14	155,366	7.2%
2014/15	161,009	3.6%
2015/16	156,498	-2.8%
2016/17	154,153	-1.5%
Overall change in period		6.4%

The Council noted that it did predict waste arisings to reduce before then increasing again, and that the outturn has been consistent with this. At the time of its response, it also stated that its current prediction for 2017/18 is 154,000, which is 18,000 tonnes higher than was modelled in the original contract in 2012/13.

As noted above, prediction of waste arisings is complex. Having reviewed the figures on residual waste since the contract was entered into, we do not consider that these indicate fundamental flaws in the predictions that were made. We noted that the tonnage is currently above the capacity which the contract was intended to provide, and a very long way above the threshold of 108,000 tonnes at which all the tonnage is at the band 1 high rate.

What matters most, though, in our view, is whether the Council acted to the best of its ability and in good faith in making the original predictions. We have not seen any evidence that this was not the case, and the fact that the process was tied into the Core Strategy process which was subject to rigorous public examination provides strong evidence that it was soundly based. It is the tonnages which were predicted

at that stage which impacted on the Council's decision-making around the contract, and not any subsequent observed trends.

Pricing structure

Your objection stated that the contract 'has a pricing structure that provides a very significant disincentive to recycle.'

The price paid by the Council for waste disposal is based on a 'gate fee' per tonne of waste delivered to the plant. In band one, which applies to the first 108,000 tonnes per year, the gate fee is £146.36 (at 2011 prices). In band two, which you stated the Council pays for any tonnage above 108,000, the fee is £15. You did not comment on band three.

You have suggested that, because the gate fee for waste of over 108,000 tonnes is so low, there is a significant incentive for the Council to send any waste over this threshold to the plant, rather than incurring costs in having it recycled. The pricing structure thus discourages the Council from treating waste as far up the waste hierarchy as possible.

In its response to your objection, the Council stated that this pricing structure is designed to achieve a sharing of demand risk between the Council and the contractor. The 108,000 tonnes represents the guaranteed minimum tonnage, and it is therefore sensible for the fixed costs of the plant to be recovered through the price charged up to this threshold. If this tonnage is not met, the Council will still have to pay for the capacity and the contractor will thus still recover the fixed costs of the plant. The tonnage threshold was set well below the forecast tonnage (which varies through the life of the contract) – to do otherwise would increase the risk facing the Council that the minimum tonnage would not be achieved.

Band two is payable between 108,000 tonnes per annum and the forecast and is intended to cover the contractor's variable costs plus profit. Above the forecast, band three is payable and is at a higher rate intended to reflect the fact that at that level for throughput, the Council's waste will be supplanting commercial third party contracts, given the limited overall capacity of the plant. The Council thus maintains that there is a strong incentive to keep throughput below the forecast level, and thus an incentive to recycle.

The Council also comments:

'..it is perhaps worth considering if an alternative structure could have been used. The Council could have asked bidders to take more demand risk but this would have come at a cost (the contractors would have increased the contract price of the proposed solution to protect themselves against the risk), also this position was one common across all bidders and was what the market was comfortable with.'

In addition, the Council points out that, to a high degree, actual rates of recycling are determined not by the gate fees available to the Council in disposing of residual waste but by public behaviour. When supporting recycling schemes, the public is influenced by their beliefs, education and the collection systems available.

In relation to your specific suggestion that there is an incentive for the Council to, in effect, incinerate recyclables in order to minimise costs, the Council has pointed out that to do so would impact on the efficiency of the plant, which is designed to run on a specific mix of residual waste, and would therefore be resisted by the contractor.

In our view, the way the Council has structured the pricing in the contract is not unusual and provides a reasonable distribution of the demand risk between the Council and the contractor. While the average cost per tonne does clearly reduce as the level of waste increases, which may be as a result of lower recycling rates, the Council does not have direct influence over recycling rates. Furthermore, while the average rate per tonne decreases as tonnage increases, the overall cost to the Council continues to increase (because the lower rates for higher volumes of waste only apply to the proportion of waste that is produced over the threshold for the lower rates – the Council still pays the higher standard rates on all waste produced up to that threshold), which provides a counter-incentive.

Timing of contract signature

You have suggested that the Council's decision to sign the contract before planning permission had been granted was inappropriate as it exposed it to the risks associated with planning delays. In the event, the planning delays have indeed led to the cost of the contract increasing significantly.

The Council has stated that it is normal practice for such contracts to be signed before planning permission has been obtained in order to increase the level of certainty over costs such as the costs of servicing debt which can vary significantly in a short time period. The Council also points out that the standard form of contract used (SOPC4) envisages this and that none of the Council's external advisors had any concerns about this.

Schedule 26 of SOPC4 covers planning issues. Within this, section 3.2 sets out actions in the event of satisfactory planning permission not being achieved by the 'longstop date' and paragraph 3.3 provides for the RPP process. It is thus clear that the standard contract envisages that the contract may be signed before planning permission is obtained, although the existence of such provision in a standard contract does not of course indicate that such an approach is good practice.

We have also reviewed a range of guidance made available to authorities by HM Treasury and DEFRA and this does suggest that contract signature before planning permission is the norm. For example, in section 2.1.1 of DEFRA's 'Guidance on managing a residual waste treatment contract', it states:

'in the waste sector there is normally a long period between Contract signature and operational commencement due to the requirement to secure planning consent…..'

Later in the same document (section 2.2) it outlines the responsibilities and risks involved where planning consent has not been secured before Contract signature.

In our view, it is a matter of judgement for each council whether to achieve contract close before planning permission has been obtained. Bids for new build waste facilities have always been sought on the basis of no planning permission being in place as it may not be practical or sensible to have multiple separate planning permissions submitted potentially for the same site. An alternative to this would be for a council to submit the planning application itself in advance of the procurement, but this would only be appropriate where it is clear what technology and size of facility it wants and bidders are being asked to compete to deliver a specific solution that the council has already decided upon. Where planning is left open, as in this case, bids are priced and compared taking into account the approach to planning risk (a risk outside both parties' control given the independence of the council's planning function).

Having selected a preferred bidder, a council has two options:

- Firstly it looks to reach financial close as quickly as possible and mitigate some of the other financial risks that remain open such as exchange rate and interest rate risk. Assuming planning is delivered as hoped then the price has been locked down and fixed.
- Alternatively, it waits for planning permission to be granted, then these other risks remain open, and it still has to deal with the same issues of potentially having prices readjusted for the impacts of any planning delay or planning conditions.

Under both of these approaches, a delay in obtaining satisfactory planning permission can have a significant detrimental impact on the pricing of the contract. In the Gloucestershire case, if the contract had not been signed in advance of planning permission being obtained, the risks which the Council was exposed to could have been greater to those which it was exposed to (and which were realised) having signed the contract, if various factors such as interest rates had varied beyond the parameters built into the contract.

In our view, then, the Council, having taken appropriate advice, was entitled to take the view that it took in terms of where this balance of risks lay and to decide to reach contract close without planning permission having been obtained. In doing so, it took a view which other authorities have previously taken and which it is therefore hard to argue is unreasonable. In the event, the Council did incur significant additional costs as a result of the planning delay, but it may have suffered similar or even worse consequences had it not closed the contract when it did. We have not sought to model what the

potential impact of the alternative decision would have been, as this would be an exercise in hindsight of little relevance to the rationality of the original decision.

Termination costs

Your objection stated that the contract 'has termination costs that can be met by the capital already committed, and are significantly lower than was reported prior to full disclosure of the contract.'

Our understanding is that this element of your objection is intended to demonstrate that, at the time your objection was made, it was not too late to cancel the contract, should we find that the contract did not offer VfM (as to which, see above) or was in some other way deficient.

In your objection, you estimated that the contract could have been terminated in April 2017 at a total cost of £36m, and that this figure is less than the capital payment the Council was due to make under the contract (£30m) and the value of the site which could be released (£7.4m).

The contract, in accordance with the standard SOPC4 model, provides for two types of termination scenario:

- termination on grounds of Force Majeure
- Authority voluntary termination.

The Council has suggested that termination on the grounds of Force Majeure would only have applied up to the point that the Revised Project Plan was signed and could have arisen had satisfactory planning permission not been gained or had the RPP not been approved. The Council's financial advisors, EY, calculated (in November 2015) that the cost of such termination would be £59.8m, which essentially covers the contractors' wasted costs and puts them back to the position they would have been in had the project never started. The most significant elements of this cost relate to breakage costs on interest rate and foreign exchange swaps and termination of the senior debt. It is usual for PFI contractors to enter into interest rate swaps on contract signature in order to give them certainty over interest rates reflecting the rates built into their models, and these swap agreements can be very expensive to break.

After signature of the RPP (and therefore by the time you made your objection), the only available termination was Authority Voluntary Termination, which could have been instigated for any reason but would have been very expensive, requiring the contractor to be compensated such that they were in the position they would have been had the contract run its full term. It therefore includes not only wasted costs but also the profits which the contractor would have been likely to make from the contract. The Council's financial advisors, EY, estimated that the cost was already in excess of £100m in November 2015, although this would be subject to a negotiated settlement and EY did not undertake a formal calculation. Given the calculated Force Majeure termination amount of almost £60m and the far more favourable terms (to the contractor) of Authority Voluntary Termination, we see no reason to question EY's view that the latter would be in excess of £100m.

We agree with the Council's view that, by April 2017, the only termination route would have been Authority Voluntary Termination, which would be required to put the contractor in the same position as if the contract had run its full term. This would include payments for a wider range of elements than those which were included in your £36m estimate, which appears to be on a wasted costs basis and therefore more akin to a Force Majeure termination. We also note that EY's estimates in their detailed estimates for a Force Majeure termination (e.g. in relation to interest rate swap breakages) are far higher than in your submission, but it is the former which are based on an understanding of the nature of the contract and the underlying financing arrangements.

As noted above, the contract used was based on the standard SOPC4 recommended by DEFRA, and we have confirmed that the clauses relating to termination are unchanged from the standard ones. While we have not looked in detail at any specific advice which was considered on this aspect, the Council has informed us that its legal and financial advisors were closely involved in all aspects of negotiations around the contract and would have expressed concerns about use of the standard terms if they had had any concerns. Overall, in our view, it is reasonable for the Council to use the standard terms from the published contract, because these can be assumed to reflect market expectations and an appropriate apportionment of risk, which is acceptable to the market and to authorities.

You alleged that the costs of termination were overstated in order to ensure that councillors did not vote for discontinuation of the scheme when a motion to that effect was put before them at an Extraordinary Council Meeting on 18 February 2015. The meeting took place because of a motion put to Council by five members, and there was no officer report. The minutes of that meeting record that a potential termination figure of £100m was discussed, but this was clearly not the first occasion on which this figure had been used, and we note that it was mentioned by the councillor who proposed the motion to be £60m to £100m – which reflects EY's subsequent estimates for termination costs from a Force Majeure and Authority Voluntary termination respectively.

While we are unclear as to the exact means through which these figures came to be quoted at the meeting, the fact that they are in line with EY's estimates means that in our view, the voting in the meeting was not distorted by inaccurate information.

Use of PFI

Your objection stated that the contract 'is a form of long-term PFI contract, widely recognised as inflexible and expensive.' You point out that a number of commentaries have commented on the drawbacks of PFI as a model, including its inflexibility. You also suggest that a number of councils have recently terminated their long-term waste contracts after only a few years, because the long-term contracts were inflexible and cancelling them provided better VfM, despite the need to meet cancellation costs. You cited Norfolk, Thurrock, Sheffield, Greater Manchester and Peterborough.

In its response to your objection, the Council maintains that PFI can be appropriate for delivery of major and complex capital projects with significant maintenance requirements. It lists a range of features of successful PFI projects, including:

- Ensuring that buildings are constructed to a high standard
- High standards of maintenance throughout the life of the assets
- Facilities completed on time and within budget.
- Successful transfer of risk to the private sector
- The benefits of output-based specifications.

Since you made your objection, the National Audit Office has published a report on PFI and its successor PF2 (PFI and PF2, January 2018). The report acknowledges the criticisms which many commentators, including yourselves, have made about PFI, but also acknowledges its perceived strengths, including the increased certainty of capital costs and higher quality, well- maintained assets. It provides data on the extent to which PFI leads to higher financing costs but concludes that there is still insufficient data regarding the benefits of PFI which are gained in return for these higher costs.

In our view, while procurement through PFI does have drawbacks, particularly around costs and inflexibility, there are also clear advantages, particularly when procuring very specialist, technology-driven assets for which the public sector has less expertise. Furthermore, in our view, and whatever the form of contract involved in a waste disposal scheme, it is the technology which drives the perceived inflexibility. If the technological solution requires a significant capital investment which is likely to have a long life, there is bound to be a degree of inflexibility, whether that asset is owned by the public sector, is provided through a long- term PFI or through an outsourced service contract.

Under such circumstances, the key is to achieve the best balance of risk-share - to keep the market engaged – with the maximum possible flexibility and incentivisation within the contract.

The Council's response also addresses your suggestion that a significant number of long-term waste contracts have recently been cancelled by the relevant councils. The Council states that the overriding reason for these terminations is that, because of the general budget cuts which councils have had to make in recent years, the contracts are no longer affordable. This is, in the Council's view, a different issue to whether or not the contracts provided value-for- money. Affordability, as mentioned above, was considered in the EY report.

The Council also comments on specific contracts as follows:

- Peterborough – the waste and recycling contract with Amey which was terminated was one of two waste contracts: the Council still has a contract with Viridor which incorporates EfW.
- Sheffield – the Council voted to end its overall waste contract with Veolia but was considering entering into a new contract to operate the incinerator plant
- Norfolk – the Council in any case sends a high proportion of its residual waste to neighboroughing Suffolk, where it is disposed of through EfW anyway.
- Greater Manchester – one of the main factors behind the proposed termination of the PFI contract in Manchester was issues in relation to repairs and reliability of the MBT and composting facilities, and not concerns about EfW.

From our review of the circumstances in these cases, there does not appear to be an overall pattern which indicates that long-term EfW contracts are unreasonable:

- In Peterborough, the EfW plant operated by Viridor only came into operation in 2016, and the contract which was terminated, seven years into its 23 year life, was a service contract with Amey for a range of services including waste collection and street cleaning.
- In Sheffield, it appears from cabinet reports that the reason for the proposal to recommission the service arose from the overall financial context of the Council ie its need to make savings in the light of reduced government funding. In the event, the contract with Veolia has been recommissioned and they are continuing to operate the EfW facility as well as providing the waste collection service and the district heating scheme, all of which were covered by the same contract.
- In Norfolk, the Council withdrew from its contract for an EfW plant in Kings Lynn because of the impact of planning delays on the VfM of the project, and not because of any problem with the principle of entering into a long term contract of using EfW. It is now reliant, under an arrangement lasting until 2020, on an EfW in neighbouring Suffolk to dispose of residual waste while it develops its own new plans for disposal.
- In Manchester, the contract was particularly large and complex, and there was a range of reasons why the Waste Disposal Authority decided to terminate it. These included issues to do with the condition of the assets and the financial situation of a sub-contractor as well as the need to make savings of a level which was not envisaged at the time the contract was entered into.

In our view, these examples do not indicate that entering into long-term contracts for waste disposal is universally undesirable, although to a limited extent they do illustrate that it can be hard for savings to be made in a time of shrinking overall budgets. However, in the context of waste disposal, there are in our view few realistic alternatives to longer- term contracts. Given the costs of the infrastructure to service such a contract, no private provider is likely to enter into a shorter term contract (other than in respect of any surplus capacity which arises from a long term contract with another party). The risks for the public body in not working with the private sector are high given the specialist nature of the required assets and the complexity of laws and regulations for this area.

Legislative change

Your objection stated that the contract ‘has hidden future costs because it is not in line with expected changes in regulation.’ You comment on the continued legislative and policy emphasis on increased recycling and other possible legislative changes including taxation and the requirement to remove further elements from the waste stream before incineration.

The Council’s response to your objection clarifies how the risks associated with legislative change are managed in the contract:

- The cost of compliance with current or foreseen legislative change at the time of inception is built into the contractor’s pricing.

- For legislative changes which are not reasonably foreseeable, the contract provides a mechanism (section 44 and schedule 21) under which any additional costs arising from changes in the law can be recognised and be the subject of negotiations between the Council and the contractor.

The above mechanism is normal for PFI contracts and reflects the arrangements set out in SOPC4. It provides for different levels of change required to the contract and for different types of change (e.g. additional capital spend, loss of revenue, increased unitary payment etc) and includes an escalation process for such changes, including provision for the use of independent technical experts.

We note that in this instance, however, you have specific concerns about more significant possible future changes in laws and regulations relating to waste disposal which could undermine a long-term EfW contract and which, by implication, could be very hard to accommodate within the existing contract. You were particularly concerned that in 2015, when the VfM of the project was re-evaluated and the Council could have terminated the process during the RPP stage (albeit at considerable cost), no analysis was carried out of the impact of developments in the regulatory framework since the contract was signed in 2013.

We agree that, on balance, it would have been better for the Council to formally revisit this aspect of the project before agreeing the RPP, to ensure that there were no major changes in the regulatory environment which would have a major impact. We note, however, that at this stage:

- The Council's focus was on successfully negotiating the RPP for the contract which it had signed two years earlier, rather than on revisiting whether it should have signed that contract
- While we recognise that there was considerable discussion and consultation on possible regulatory changes (circular economy proposals, EU plastics strategy etc) during that period, you have not identified any actual major changes which impacted on the contract
- The contract in effect shares risks arising from unforeseen legislative change, but the contractor, as a commercial entity with a good knowledge of the regulatory environment, proceeded with the contract and must therefore have considered that its share of these risks was manageable and did not fundamentally undermine the contract.

The Council submits that it did formally revisit whether, as a result of the planning delay, there was an increase in the likelihood of legislative change which would impact on the operation of the contract during its term. The Council further submits that it is in the interests of both the Council and UBB to ensure that the Waste Law List, whereby current policies and proposals are listed for the purposes of being a Qualifying Change of Law (a term defined in the contract) is up to date and takes account of potential forthcoming legislation where that is realistic. The Council says that in 2015/16 the parties to the contract considered the matter fully and determined that there were no likely major changes in the regulatory environment which would have a major impact on the contract.

It is in our view inevitable in any long-term contract that there are risks associated with legislative change, but that does not mean that long term contracts should be avoided. It means that appropriate mechanisms need to be built into the contracts to deal with the consequences of legislative change and that, when entering into the contract, the risks are clear and decision-makers can make an informed judgement about them in the context of the contract as a whole.

Technological developments

Your objection stated that the contract 'forecloses the opportunity for competition from new, improved technologies.' As part of this concern, you pointed out what you saw as an inconsistency in the procurement process whereby the Council claimed that the procurement was 'technology neutral' (ie that they were open to bidders proposing any of the available technologies for disposal of residual waste) yet the procurement evaluation also specified that only 'closed loop' solutions would be acceptable. A closed loop solution is one which does not leave any residual waste or by-product after treatment of the residual waste stream. You argue that, because MBT and similar technologies do leave a residual product, that they were precluded from the procurement process.

In response to this, the Council maintains that insistence on a closed loop solution does not preclude technologies such as MBT. It is still possible for a bid to include MBT but also provide a closed loop

solution if the bid includes the appropriate disposal or use of the output from the process. In support of this, the Council states that 3 of the original 8 bids, and 1 of the 4 bids which went forward to the next stage, incorporated MBT.

Another of your concerns was that, following the delays to the project caused by the planning issues, the Council did not re-evaluate its decision to pursue energy-from-waste to take account of improvements in other technologies which had occurred since the original contract evaluation. You outlined the increased reliability and feasibility of recognised alternative technologies and the emergence of further technologies.

In response, the Council has stated that it could not have re-evaluated the possible costs and benefits of other technologies without carrying out a fresh procurement exercise. Instead, it instructed its financial advisors, EY, to revisit the VfM assessment of the project which compared its costs and benefits against the baseline of continuing with the existing technology of landfill.

As with the evaluation of changes in legislation discussed above, it would have been better for the Council to document a formal consideration of the impact of technological developments prior to agreeing to the RPP. We again recognise, however, that the Council's focus at that time was on negotiation of the RPP within the existing signed contract and any reassessment would, in our view, have needed to identify significant issues to lead the Council to move away from the signed contract.

Inappropriate baseline

Your objection stated that the contract 'uses the inappropriate baseline of landfill as a comparator over 25 years'. Your concern is because landfill is no longer a viable option for waste management over the lifetime of this contract and is likely to only be permitted for inert (as opposed to all residual) waste within 10 years.

The Council, in its response to your objection, stated that it had used landfill as the comparator throughout the procurement exercise, including comparing various other technologies against the same comparator of landfill. In the Council's view, use of a consistent comparator aids comparability and creates a 'level playing field', with all proposals measured in terms of how far they vary from that comparator.

The October 2015 EY report which was the final assessment of the VfM of the proposed contract, towards the end of negotiations around the Revised Project Plan, did indeed compare the costs of the updated base case against the comparator of continuing to landfill.

It is important to consider this VfM assessment in context. It was not the only such analysis completed during the entire process – the report to Cabinet in September 2012 included an analysis of the VfM of the proposed EfW contract against the 'do nothing' landfill option. At this stage, it had been shown through the competitive procurement process that the EfW contract was the best of the options available to the Council and it was appropriate to compare this 'best option' against the 'do nothing'.

Three years later, because of the planning delays and the RPP process, the original VfM analysis was no longer valid – the costs of both the EfW contract and the 'do nothing' had increased due to the passage of time and the impact of this on various costs. In order to understand the impact of this, the Council asked EY to consider the VfM of the RPP, still using the same 'do nothing' option. As a result, the Council now understands what the impact of the delays has been.

We have asked the Council whether it considered using a different comparator, for example WRAP spot prices which were available at the time. The Council's response is that, for the same reasons as set out above in the section on assessing the actual VfM of the RPP, those prices were not appropriate or sufficiently reliable comparators and that there was no available market data which would have provided an appropriate comparator. For the same reasons we are of the further provisional view that it would not be appropriate for the auditors to carry out the analysis required in order to determine the actual position on VfM. Had the alternative comparator information been available the Council would most likely have instructed EY to have considered this and the only way that this would have been available in a reliable form would have been for a repeat procurement exercise to have been carried out.

Therefore, the Council does not know from the EY report whether EfW would still have been the best option of all available technologies if it had started a new procurement exercise at that time. But the only way to understand this with any certainty would have been to run a new procurement exercise, which would have led to not only the termination cost, but also the increased procurement costs, created further uncertainty and delay, and had an adverse impact on the Council's reputation in the marketplace, leading to potentially higher bids being submitted or less interest from contractors. In our view, given EY and the Council's views on affordability at the time, the Council was not required to adopt such an approach: it was not a necessary part of arrangements to secure VfM. The separate question of whether a new procurement was required by law is addressed above.

Evaluation of benefits

Your objection stated that the contract 'anticipates benefits that will only occur in ten years or more, based on projections which cannot be substantiated and therefore present high risk.'

The Council, in its response to your objection, underlines the need for the planning for long term infrastructure projects to take into account costs and benefits over the full life of the project. In relation to electricity costs, the Council states that it used government-published long-term price forecasts over the life of the asset and calculated a three point estimate taking into account estimates, best case and worst case scenarios.

The Council has also pointed out that the VfM of the project is not in any case dependent on the 'credit' from electricity – even in the worst-case modelled scenario for electricity prices, the project demonstrates a lower NPV than the landfill comparator.

In our view, the Council has acted reasonably in making assumptions about the benefits to be gained through electricity generation. We accept that there is a degree of risk involved in making such estimates over the long contract life, but the way the Council has made the estimates minimises that risk, by using reputable sources for the predicted prices and modelling on different scenarios.

Social Value

In a follow-up email to your objection on 20 June 2017, you outlined further concerns that the Council's evaluation did not reflect the Social Value which is currently achieved through effective use of landfill tax credits. You pointed out that there is evidence that for every £1 of landfill tax credit invested, there is an impact on local communities worth around £9.

The concept of Social Value was embodied in statute through the Public Services (Social Value) Act 2012. The Act requires (in section 1(3)) public authorities entering into contracts to:

'…..*consider—*

a how what is proposed to be procured might improve the economic, social and environmental well-being of the relevant area, and

b how, in conducting the process of procurement, it might act with a view to securing that improvement.'

A related amendment was made to the Local Government Act 1988 to enable local authorities to take into account non-financial considerations to the extent necessary to comply with this Social Value duty.

In its response, the Council points out that the Act came into force on 31 January 2013, four years after the procurement process commenced, and that there was thus no requirement to comply. As the actions required by the Act are to be taken before a procurement process commences, we agree with the Council that there was no requirement to comply, even though the contract was not signed until slightly after the commencement of the relevant sections of the Act.

The Council also indicated that it did include social value criteria within the contract evaluation, even though it was not required to by the Act. It stated that these were referred to as social management, added value, lifecycle analysis and environmental control. It also points out the additional social value which the scheme will provide, including requirements for guaranteed interviews for local residents and

creation of a community fund by UBB. It did not, however, comment specifically in relation to the loss of the social value associated with landfill tax credits.

It is, in our view, far from certain that the Council should have taken into account the Social Value gained through landfill tax when evaluating the proposals, because:

- the 2012 Act did not apply to this procurement
- while the use made of landfill tax does create significant Social Value, the whole concept of landfill tax is intended to act as a disincentive to landfill and, given that the whole aim of the procurement was to move away from reliance on landfill, to factor in the Social Value gained from the tax which in part incentivises what the Council is doing appears to us to be perverse
- given that all of the proposals would have involved diversion from landfill, they would all presumably have had broadly the same Social Value reduction.

However, for the sake of completeness, we note that the if the Council could not have relied upon exceptions within the PCR 2015 when agreeing the RPP and entering into the re-signed 2016 Contract and it had to re-run the procurement – a point we have not determined within this objection - then the social value duty would have applied to that renewed procurement process (as it would have commenced after the 2012 Act was in force).

Additional governance concerns

We have above addressed the concerns raised in your objection to the Council's 2016/17 accounts. In the course of commenting on the provisional views we provided to you for your comments, you have sought to enlarge the focus of our inquiry, beyond the scope of the objection, to include complaints about impropriety on the part of the Council's officers (including in particular an alleged conversation between the Council's Chief Executive and the then Chairman of the OSM Committee on 19 November 2015), the making of misleading statements by the Council (regarding, e.g., 'cost savings' to the Council arising from the contract), and inadequate internal governance relating to the taking of decisions regarding the contract. You have also raised concerns about the roles played by professional advisers to the Council, including Grant Thornton, and alleged 'conflicts of interest' on the part of such advisers. We comment on these below, but not as part of our response to the objection insofar as these go beyond the scope of the original objection.

Given the time and resources that we have already expended on considering your objection to the Council's 2016/17 accounts, we do not consider it appropriate or that we are required to enlarge our inquiry to consider all these various additional concerns you have raised. As already explained above, we have considered the way in which the Council came to the decision to agree the modifications to the contract that were made by way of the 2016 Contract, and have found that the Council's agreement of the modifications was pursuant to advice from appropriate external experts supporting a conclusion that this course represented the best value option available to it in the circumstances. Against that background, we do not consider it proportionate to enlarge our inquiry to consider other potential concerns in the context of our audit of the Council's 2016/17 accounts. It is necessary to keep our inquiry regarding those accounts within reasonable bounds, and not allow it to morph into a disproportionately broad inquiry, of ever-enlarging scope, seeking to identify any aspects of the Council's internal governance or commitment to transparency which you may view as sub optimal.

With regard to the allegation concerning a meeting between the Chief Executive and the Chairman of the OMS Committee, we note that you say that the latter individual made you aware of this meeting in 2018 but that the meeting is alleged to have taken place in 2015. You say that the same individual has reported the matter to the Police, which investigated whether any offence of 'misconduct in a public office' had been committed, but no further action has been taken. It would not be proportionate for us to seek to carry out a factual inquiry in these circumstances, such as by ourselves interviewing relevant individuals, so as to decide matters which are properly for our audit of the 2016/17 accounts.

With regard to the Council's internal governance: you have alleged that the 2016 Contract was "wrongly entered into in secret by a small group of councillors and officials" and that "there has been a deliberate campaign of concealment of the facts by this 'cabal' in order to hide this wrongful expenditure and that

the public and key Council oversight committees have been actively misled." In our view, however, you have not identified evidence constituting a reasonable basis for such allegations regarding the Council's internal processes such as to warrant further investigation by us, having regard to our function and remit. The Council's decision to agree the 2016 Contract was approved by the Council's relevant governance mechanisms on the basis that it appeared to represent VfM for the Council in the circumstances, and this was consistent with the expert advice the Council had received from EY. In the circumstances we do not consider it proportionate to devote resources to inquiring in detail into whether there are ways in which the Council's internal processes by which it took this historical decision could have been further improved.

With regard to the making of statements by Council officers, either to the Audit Committee or to the public at large, which you say were misleading, and/or 'misconduct' by Council officers in seeking to prevent certain information being placed into the public domain: in our view, you have not identified evidence constituting a reasonable basis for such allegations such as to warrant further investigation by us, having regard to our function and remit. As stated above, the Council's decision to agree the 2016 Contract on the basis that this represented VfM was reached by means of the Council's relevant internal processes and was consistent with the external advice it received. Statements to the effect that the 2016 Contract represented VfM for the Council, or as to the limited nature of changes to the 2016 Contract as compared with the 2013 Contract, are essentially matters of opinion or judgement. It is not our function to 'regulate' the Council in terms of whether it is sufficiently committed to transparency, or whether it has unjustifiably refused to release information in response to Freedom of Information Act requests. You have told us that the Council's refusals to release information in response to such requests has been considered by the Information Commissioner's Office and in subsequent tribunal proceedings: those are the proper bodies to consider those matters.

With regard to alleged 'conflicts of interest' on the part of the Council's professional advisers: we do not consider you to have identified evidence constituting a reasonable basis for such allegations such as to warrant further investigation by us, having regard to our function and remit. So far as Grant Thornton is concerned, we follow strict internal rules, in compliance with the Ethical Standard set out by the Financial Reporting Council, to ensure that our audit function is carried out independently of any role another part of our organisation have played in advising in relation to any project. In this case, we considered when first starting to consider your concerns whether there was any conflict of interest from the firm's previous involvement at a much earlier stage of the project, and concluded that there was no such conflict.

In relation to the role of solicitors Eversheds Sutherland, we see no improper 'conflict of interest' arising because they have advised the Council on multiple matters relating to the contract and the EfW project to which it relates. It is for the Council to choose its own professional advisers, and it is in principle entitled to see benefit in continuing to take advantage of the knowledge accrued by a particular solicitors' firm in relation to a particular project or subject matter. Likewise, your criticisms of the Council for running up fees with Eversheds Sutherland for contesting proceedings under the Freedom of Information Act are matters you may wish to draw attention to in the arena of public debate, but we do not consider this a matter that we need to inquire into as part of carrying out our audit function in relation to the Council's 2016/17 accounts.

We note that the key advisers to the Council in relation to whether the 2016 Contract represented VfM were EY and that you have not sought to allege 'conflicts of interest' or impropriety on EY's part.

Decision as to whether to issue a Public Interest Report

Whether or not to issue a report in the public interest is a matter for us in the exercise of our discretion. Relevant factors include the quantum of any loss, whether there were significant failings in governance, whether the matters that might be the subject of a report are on-going, whether there has been significant publicity in respect of the issues, whether we have recommendations to make to the Council and whether we believe that our independent view should be expressed in public.

We have carefully considered the above factors in relation to your objection and subsequent representations.

We consider it appropriate for the public, who have shown considerable local interest in these matters, to have an account of the procurement issue and our views on this. We are satisfied that this should be by way of a report to the Council's Audit Committee. Our view is that the report should cover that:

- the Council's entry into the 2016 contract with UBB resulted in an increase in the contract value in the region of £150m, which is a large sum of money (albeit that the Council notes that a significant proportion of this increase was provided for in the original 2013 Contract and is related to actual cost increases incurred by the contractor) and which was agreed after a lengthy period of negotiation;
- the 2016 Contract is ongoing with the Council making significant annual payments under its terms;
- the signing of the 2016 Contract has been the subject of a legal challenge to the Council's actions based on public procurement law; the challenge was dismissed by the High Court on the basis of a preliminary point and permission to appeal has been refused by the Court of Appeal. Therefore it appears that the courts will not consider the lawfulness of the amendments to the contract;
- we have concluded that it is not possible for us to come to any definite conclusion, based on the material currently available to us, as to whether the Council's entry into the 2016 Contract with UBB involved a breach of procurement law, and that it would be disproportionate for us to seek to determine whether there has been a breach of procurement law in the circumstances. To do so would require us to employ our own range of specialist advisors and would be very expensive and time consuming, and could ultimately still produce an inconclusive result. The practical value to local electors of our coming to a firm conclusion on that matter would anyway be limited given that the contract is already in operation and an attempt to challenge the contract in the High Court has already been mounted and been unsuccessful.

The Council has indicated to us that it understands that we wish to put our position on this matter on public record and that it will consider any report in a public meeting of its Audit Committee .

Having considered this matter carefully and further to the final submissions from the Council and the objectors, we have decided that, on the understanding that the Council will ensure that any report we do issue is publicly available and considered in a public meeting of the Audit Committee, we will not issue a Report in the Public Interest. As our conclusions do not contain any recommendations or any material criticisms, and our main objective is to explain why we have not reached a definitive conclusion, rather than to express such a conclusion, we do not consider that anything further by way of public reporting and consideration by a Committee of the Council is required.

We have in addition, decided not to issue a report in the public interest or to produce a report for Audit Committee on the other matters raised because:

- in our view the Council has made satisfactory arrangements for securing VfM;
- while there are risks in entering into a long-term PFI contract, the Council was aware of these risks and used a standard form of contract with a view to achieving a reasonable share of these risks between itself and the contractor;
- while the Council could arguably have undertaken a more formal reassessment in 2015 of non-financial aspects such as technological and regulatory developments, this is a matter of judgement and the absence of such a reassessment does not show that the Council lacks satisfactory arrangements for securing VfM;
- whilst we understand your arguments as to why you do not consider that the contract provides VfM over its lifetime, this is a matter on which reasonable differences of view are possible: it is, even now, impossible to predict with certainty whether the contract will prove cheaper than alternative waste disposal options over its long lifetime. In any event, it is not our function to 'second-guess' the Council's judgements about such matters which appear to have been made in good faith with the assistance of appropriate external advisers. Nor would it be appropriate for us to criticise the Council's judgements with the benefit of hindsight based on recent evidence as to average prevailing costs of disposing of residual waste through different methods.

Decision on whether to make an application to the Court

If we are satisfied that there is an item of account that is contrary to law, we have a discretion as to whether we apply to the Court under s28 of the 2014 Act for a declaration. As far as our investigation has taken us, we have not identified any item of account that is unlawful (mindful however that we have not come to a definitive view on the lawfulness of the RPP in terms of procurement law). Moreover, even if we had identified such unlawfulness, we would not exercise our discretion so as to apply for a declaration. Relevant factors in the exercise of that discretion include:

- the significance of the item of account which may be contrary to law
- the costs of applying for a declaration
- the prospects of success
- the practical consequences of a declaration
- whether seeking a declaration would help to clarify an area of legal uncertainty
- whether the matter is of wider concern rather than just confined to the present context.

We do not consider it appropriate to seek such a declaration in this case, because:

- we consider that the Council has satisfactory arrangements for securing VfM;
- in terms of whether the entry into the 2016 Contract (i.e. the modifications to the contract at the RPP stage) was compliant with procurement law, we have concluded that it would be disproportionate for us to ourselves seek to make a determination on this point. It would likewise be disproportionate for us to ask a Court to make a determination, as we would not have the evidence needed for persuading the Court to determine that the Council had breached procurement law;
- the lawfulness of the 2016 Contract has already been the subject of court proceedings in which the High Court declined to deal with the challenge substantively, since the challenger did not have standing to bring the claim;
- procurement law generally prescribes strict time limits for bringing proceedings, and this reflects the public interest value of certainty as to the validity of a contract after a period of time specified in the relevant legislation has passed. In the present case that period has plainly passed, and further, the contract has been in operation for some time. Even if a Court were persuaded to make an ‘unlawful item of account’ declaration in this case, this would have limited benefit to local electors as the Council’s obligations under the 2016 Contract would be unaffected;
- the costs of seeking a declaration would be high and these would effectively be passed on to local taxpayers;
- the issues underlying these matters are very fact specific such that there would be limited wider public interest in a court declaration.

Right of Appeal

You have a right to appeal our decision not to apply for a declaration under section 28(3) of the Local Audit and Accountability Act 2014. Please note that there is no right of appeal against a decision not to issue a public interest report.

Should you wish to appeal this decision, you must issue your appeal with the Court within the period of 21 days beginning with the day after you receive this statement of written reasons. We strongly recommend that you seek legal advice before seeking to appeal.

A copy of this letter is being sent to the Council.

Yours sincerely

J Gregory

John Gregory

Director

For Grant Thornton UK LLP