Cynulliad Cenedlaethol Cymru
The National Assembly for Wales

Pwyllgor Cyllid
Finance Committee

Dydd Iau, 10 Ebrill 2008
Thursday, 10 April 2008

Cynnwys
Contents

Cofnodir y trafodion hyn yn yr iaith y llefarwyd hwy ynddi yn y pwyllgor. Yn ogystal, cynhwysir cyfieithiad Saesneg o gyfraniadau yn y Gymraeg.

These proceedings are reported in the language in which they were spoken in the committee. In addition, an English translation of Welsh speeches is included.

Aelodau'r pwyllgor yn bresennol
Committee members in attendance

Alun Cairns	Ceidwadwyr Cymreig (Cadeirydd y Pwyllgor) Welsh Conservatives (Committee Chair)
Mohammad Asghar	Plaid Cymru Plaid Cymru
Angela Burns	Ceidwadwyr Cymreig Welsh Conservatives
Alun Davies	Llafur Labour
Ann Jones	Llafur Labour
Alun Ffred Jones	Plaid Cymru Plaid Cymru
Lynne Neagle	Llafur Labour
Jenny Randerson	Democratiaid Rhyddfrydol Cymru Welsh Liberal Democrats

Eraill yn bresennol
Others in attendance

Dave Galligan	Pennaeth Iechyd yng Nghymru, Unsain Cymru Head of Health in Wales, Unison Wales
Simon McCann	Cynghorydd Arbenigol i Ymchwiliad y Pwyllgor Cyllid i Bartneriaethau Cyhoeddus-Preifat. Expert Advisor to the Finance Committee Inquiry into Public Private Partnerships
Gronw Percy	Cynghorydd Arbenigol i Ymchwiliad y Pwyllgor Cyllid i Bartneriaethau Cyhoeddus-Preifat. Expert Advisor to the Finance Committee Inquiry into Public Private Partnerships
Jon Sibson	Partner, Cangen Cynghori Cyhoeddus-Partner, PricewaterhouseCoopers Partner, Public Private Advisory, PricewaterhouseCoopers
Derek Walker	Pennaeth Polisi ac Ymgyrchoedd, TUC Cymru Head of Policy and Campaigns, TUC Wales

Swyddogion Gwasanaeth Seneddol y Cynulliad yn bresennol
Assembly Parliamentary Service officials in attendance

John Grimes	Clerc Clerk
Abigail Phillips	Dirprwy Glerc Deputy Clerk

Dechreuodd y cyfarfod am 10.04 a.m.
The meeting began at 10.04 a.m.

Ymddiheuriadau a Dirprwyon
Apologies and Substitutions

[1] **Alun Cairns:** [*Inaudible.*] I have not been made aware of any substitutions, and so I do not imagine that any will be sent.

[2] The purpose of this meeting is to further our inquiry into public-private partnerships, or the private finance initiative. The second item on the agenda is to take evidence from the unions, and the third and fourth items are to inform our factual knowledge and understanding of the processes.

[3] The usual Standing Orders apply, but I will not run through them all. I ask Members to switch off mobile phones or any other transmitting devices that may interfere with the recording equipment.

[4] I now invite our guests to the table.

10.05 a.m.

Ymchwiliad i Bartneriaethau Cyhoedus-Preifat: Tystiolaeth gan TUC Cymru ac Unsain
Inquiry into Public Private Partnerships: Evidence from WTUC and Unison

[5] **Ann Jones:** Before you start this session, I declare an interest in that I am a member of the trade union Unison.

[6] **Alun Davies:** I declare that I am also a member of Unison.

[7] **Alun Cairns:** The Record will note your declarations.

[8] I thank our witnesses, Mr Walker and Mr Galligan, for attending and for their papers, in which, I think it fair to say, they have expressed their views clearly. Please introduce your papers and give a broad overview between you in some four to five minutes, if possible. I will then start off with a very broad question, after which we will go around the table as the will of Members determines.

[9] **Mr Walker:** To kick off, I am Derek Walker, and I am the head of policy and campaigns for the Wales TUC. As you probably know, the TUC in Wales represents just fewer than 50 affiliated trade unions, made up of nearly 0.5 million members.

[10] I apologise for the mix-up at the last meeting. I appreciate that that caused you inconvenience because of a confusion recorded in your minutes or in the transcript. We were unable to attend that meeting, so thank you for inviting us back and for finding the time to do that.

[11] I will briefly mention the Wales TUC submission, in which we have tried to outline the key, common issues identified by our affiliates. I know that you have received representation from our affiliated unions, and again today, in which they have been able to go into more detail about their particular sectors. It is fairly clear from our paper that we focused on PFI. We are concerned that PFI does not give us value for money. It does not bring about the improvement in the quality of public services that we would like, and the impact on staff is largely detrimental. However, we would be happy to take any questions on the detail of that.

[12] **Mr Galligan:** Good morning. I am Dave Galligan, and I am a regional manager for Unison. I specifically cover the health service, but the paper on PFI is wider than that.

[13] Unison has some 95,000 members employed in public services in Wales, and, quite clearly, we have long campaigned for a critical examination of PFI, primarily because of the developments across the border more than those in Wales. Many thousands of our members are, effectively, caught up in the complex world of working for the myriad sub-contractors that emerge from PFI developments. We believe that we have first-hand experience of the staff aspects of the impact of PFI. However, our report has been prepared quite comprehensively for us, and it deals with a number of critical areas that we feel the committee would wish to examine to do with the realities of the alleged transfer of risk when, at the end of the day, the Government is still the guarantor of last resort.

[14] There are issues with regard to the total absence of clarity in the PFI procurement processes, much of which is shrouded in—those magical words—'commercial confidentiality'. The fact is that most of the promoters of PFI tend to be advisers from the financial world, lawyers, the construction industry or facilities providers. Some would say that we have a vested interest, but we would suggest that their vested interests are significantly greater than ours. However, transparency in the process is absent. Above all, since 1997, there has been a total absence of any debate of whether PFI is presenting value for money. Too much is shrouded in secrecy, so that we are led to believe that PFI is the only game in town. That is the model followed across the border. We welcome the Assembly Government's position on this matter, and not just its recent position, espoused in 'One Wales', but the position that has been adopted for several years about following alternative models of public procurement to PFI. For that reason, we commend the work to date, although our report is far more comprehensive than that, and we are, as is Derek, open to answer any questions that you may have for us.

10.10 a.m.

[15] **Alun Cairns:** I thank you and Mr Walker for your papers and for your introductory statements. Mr Galligan, you mentioned that you have long called for an examination into the merits of PPP and I hope that this report will provide a small element of that in some way and contribute to the debate.

[16] You obviously have union members, so taking into consideration the fact that public money will be tighter for the next three to five years, possibly longer, than it has been for the past five years or so—that is the reality in terms of the Treasury and public sector growth and spending—if your members are working in crumbling buildings or difficult conditions because no investment has been made in the capital infrastructure for whatever reason over a long time and there is no money for traditional procurement for the public sector, what is your approach to private investment in public services in those circumstances?

[17] **Mr Galligan:** There are a number of questions there. I accept that there was a huge absence of capital money spent on health, but not exclusively on health infrastructure. You would expect me to say that that happened between 1979 and 1997, but there was a period when there was little expenditure or insufficient expenditure to keep the pace of maintaining the existing buildings. We have members working in crumbling buildings, but ultimately, whether it is paid for through PFI or a public procurement route, it is paid for by the taxpayer. The difference is which one gives you better value for money.

[18] I will not defend crumbling buildings when I think that all public sector employers have a responsibility to do more than they may have done. However, ultimately, we all pay the bill and we are paying it through public sector borrowing—and I am not an economist, so please do not ask me how this affects the Chancellor's requirements to keep things on or off

the balance sheet. We know that ultimately the bill is picked up by the taxpayer. It is questionable whether Government, in the broadest context, could have built the necessary required buildings with finance from alternative routes because there has not been any evidence, certainly not since 1997, that they have looked at alternative routes—that is certainly the case in England. I know that Wales has looked at alternative routes because we have some ongoing public procurement builds. However, the reality is that infrastructure and its maintenance is a permanent feature; it should not last only for the life of a 30-year contract.

[19] **Alun Cairns:** That is useful, but can I stop you and put the question in a different way? No doubt, different parties will make different points and I am trying to take the party politics out of this. However, the Minister's responses to written Assembly questions show that backlog maintenance, over a long time—and I want to get out of that because we are where we are—in education is £660 million. In health, it is in excess of £1 billion; that is the capital backlog in maintenance and repair. If you are in that position and public money is tight, how do you overcome the problem?

[20] **Mr Galligan:** You have to make priority decisions. That does not mean that you will get everything you want, but you have to make priority decisions.

[21] **Alun Cairns:** So, in those circumstances, would Unison and the TUC still not advocate the use of private funds? If they would, under what circumstances? That is what I am trying to tease out.

[22] **Mr Galligan:** A theme that consistently comes through is what was wrong with public procurement. A big issue with that that we cannot hide from is that it was often over budget and not on time. I would argue that that is because the public procurement builds were formerly managed by organisations such as Welsh Health Estates who were not the experts in the field. We should have employed experts in that field and brought that expertise in rather than bringing in the entire contract company to do everything. We can bring in and buy in expertise and project management that will deliver projects that are on time and on cost. However, that is not exclusively the domain of the private sector. The public sector could do that, if it was ever given the opportunity to do so, but we do not think that it ever has been. That is why the debate in England—I said 'the debate in England' because it is a very different debate there—seems to have been stifled, so that it was PFI or nothing. We do not think that it is as black and white as that.

[23] **Alun Davies:** Can I test you a bit further on that, please? On the first page of your written evidence, you say that you would like to see a comprehensive public review of the PFI experience in Wales and, as the Chair indicated, I hope that we will be able to at least begin that process in this investigation. However, you also said:

[24] 'Wales needs a genuine and wide-ranging debate about the different options for the finance of public service infrastructure. This should take account of possibilities raised in Wales and Scotland, as well as the various methods of funding and structures adopted abroad'.

[25] Could you tell us what you mean by that? You seem to be saying that there are options beyond the traditional public procurement model, but you do not seem to be saying what you believe those options are.

[26] **Mr Galligan:** There is a school of thought that says that public-private partnerships are not PFIs. The two are often rolled into one, but PFIs are private finance initiatives where the project is funded entirely by the private sector, with the public sector acting as guarantor. We believe that there could well be roles for public-private partnerships, certainly in the

development of the expertise that has been problematic in the past, which has always been about delivering the project on time and on cost. That is, again, a matter for debate. People talk extensively about public-private partnerships, but nobody ever seems to say exactly what they are.

[27] The report that we are talking about is primarily about private finance initiatives, which I see as being very different. It is a public-private partnership, but there is a greater incentivisation because there is a profit motive. The main driver for public-private partnerships should be the public getting value for money; that should be the motivation that we need. I do not think that that will be exclusively confined to something delivered by the public sector. We need to find which partners we can work with and with which partners we have the same commonality of purpose. I said at the beginning that I am not an economist, but I presume that affordability is a key factor for all directions of travel.

[28] **Alun Davies:** So, if I could just paraphrase, your objection to the PFI model is not a philosophical objection to the use of private finance. You say in your conclusion that there is a need to

[29] 'examine the scope for drawing on private finance for public sector projects'.

[30] In fact, that is in your evidence and what you have just said leads me to think that you do not have a philosophical objection to the use of the private sector in delivering public projects or services, but what you have found so far is that the PFI experience in Wales—the particular model that we have used to date—has not been successful.

[31] **Mr Galligan:** There are limited examples of PFI in Wales that we can point to. I am happy to talk about the Welsh experiences, but we have greater experience of how it has operated in England. It has been extremely questionable, shall we say, when it has involved refinancing models whereby PFI projects have moved on and people are now working for the sixth or seventh subcontractor in 10 years. That sort of model across the border is one that we would not countenance. The limited experience that we have in Wales—in health it is limited to three projects, at Chepstow, St David's in Cardiff and Baglan Moors—has shown that it still creates divisions and generates a two-tier workforce. That is one of the key aspects. We would hope that any model that was adopted would not create the divisions that come from a two-tier workforce.

10.20 a.m.

[32] **Angela Burns:** I would like to follow on from Alun's point about your philosophical view on this. I read both your papers with great interest and read some of the PFI examples and you are absolutely right that some are not good and others are good. I see the whole PFI element of PPP as an evolution from when we started off in 1997. There are some examples from 2000 and 2001 that are not great, but it is a learning process. I take your points entirely on board about risk transfer, transparency and all of these things. If we accept that we are learning from our mistakes and that we could develop a PFI contract that would answer an awful lot or all of your concerns, would your worries about it still be based on a philosophical view because there would always be a profit element of some size returned to the private sector?

[33] **Mr Walker:** We have private sector members in the TUC. We are not against a flourishing private sector, but we see real value in public servants delivering public services, and we feel that public services benefit from that. Many public servants work in the public sector through choice because they want to contribute; they could be earning more in private sector organisations, but they choose to work in the public sector, and we think that there is real value in maintaining that sort of public sector element to our public services. The other

thing to say is that, despite the evolution of PFI, the experience of the members that we represent, not just within Unison, but within other unions, is still problematic and we do not believe that new PFI projects are giving us value for money, providing better public services or having a positive impact on our staff.

[34] **Alun Ffred Jones:** Presumably, one of the attractions of PFI was that the projects were off the public balance sheets. With the introduction of the international financial reporting standards and the associated alterations to the accounting practices for PFI transactions, what impact do you perceive that this will have on the use of PFI for provision in the public sector in future? Do you think that it will change?

[35] **Mr Walker:** I do not feel that I have the expertise to give you the answer that you want to that question.

[36] **Mr Galligan:** I have seen the same reports; it will effectively put it on the public sector balance sheet. I would think that that might mean that the Chancellor would have to look at alternative methods, because the public sector borrowing requirement has always been the argument to support the PFI, in that there was no way of raising this money through other means. As I understand it, if they raised it through Government borrowing it would appear on the balance sheet. Therefore, this way it stayed off the balance sheet. You would need to speak to an economist perhaps more than Derek or myself on this. I think that it will affect future Government policy, but we are looking at Government policy in Wales, which is different. I think that it will curtail many of the more extreme PFI projects, often mooted in England, that end in financial disaster many hundreds of million pounds later, for example at Paddington.

[37] **Jenny Randerson:** May I take you back to alternative ways of involving the private sector? Several witnesses for this inquiry and people who have provided evidence have suggested alternatives to the standard PFI contract, as you know. These include the non-profit distributing model, bond issues and end-user charging; we have also shown an interest in the Scottish futures initiatives. I would like your views on the implementation of those alternative models and your ideas on which of those specific alternative models you would prefer and why, because you have said that there are alternative ways of doing it. You have obviously examined those alternative models and we would be grateful for your view on which of those alternatives are preferable and could be appropriate here in Wales?

[38] **Mr Galligan:** I do not know enough about the Scottish model. The bond issue is, possibly, more understandable, because it is a Government bond, and therefore Government-guaranteed. Any model that keeps staff as part of the team, delivering for the public service, is preferable to the current model. One of the main reasons for our opposition to PFI is the fact that staff have not even been factored in to the consequences of a PFI. Staff have become a commodity, a profit motive. I know that they have devised models that some would call ‘innovative’—others would call them ‘challenging’—but there are models in England called ‘retention of employment’ models, in which staff are seconded from their health trusts to the PFI contractor. Frankly, however, that is fraught with confusion—it confuses lines of responsibility and accountability, and nobody knows who is managing who. It creates a divided workforce. We believe that the PFI model per se, as it currently stands, creates such a divided workforce. Only brief reference is made in the report to alternative methods of funding, but it strikes me that the Government bond is at least a guarantee that the Government sees the projects as its own, rather than as belonging to somebody else. I do not have experience of any other models, however. Do you, Derek?

[39] **Mr Walker:** The only thing to add is that the not-for-profit model takes the profit element out of the situation, which has led to cost-cutting and fighting over what needs to be done to improve services. So, we see advantages in that model as well. However, as you can

see from our paper, we have not come out in favour of any particular model.

[40] **Alun Cairns:** We will pursue the line that you mentioned about staff a little further—I will come back to you in a second, Oscar, because Ann Jones wants to cover this point.

[41] **Ann Jones:** I just wanted to pick up on your point about staff, because seeing them as just a commodity in PFI is often the downfall. In the opinion of the TUC and the unions, has the introduction of the TUPE plus policy helped? What do you think should be done to retain staff and staff conditions? We see that, even when they have been transferred over—I have scars in my back from one, as Dave has, I know. When you stop the staff from transferring over, retaining them within the public service, the private contractor suddenly has to have another think about its profit margins. How do we get around that? Will TUPE plus assist us in doing that?

[42] **Mr Galligan:** Staff transfer arrangements are complex. TUPE plus only operates on the day of transfer, of course. While there is no defined lifespan for each arrangement—what happens is by default—it is a different cultural arrangement working for a contractor. Consequently, staff turnover is higher, the training is often of a lower standard, and the public service ethos disappears, and in a short time, usually in the first two years of any contract, very few of the transferred staff remain within that contract. They will either have left or have moved to other posts—in hospital terms, perhaps within the hospital environment. Two years is usually the lifespan during which any semblance of a proportion of the workforce transferring remains with the contractor, and that means that you lose that public service ethos that Derek mentioned. All the contracts will show you that very few of the original staff remain. That includes the current contracts at Baglan Moors or St David's in Cardiff. Chepstow is less complex, because it is a very small hospital, but the employment legislation to protect staff is minimal and subjective, certainly in respect of people's pensions, where they are not even required to have a comparable pension scheme. The language is 'broadly comparable', but 'broadly' seems to be very wide in my experience in this regard.

[43] **Ann Jones:** Derek, did you want to add anything to that?

10.30 a.m.

[44] **Mr Walker:** I would just concur. You have probably heard in previous evidence that that is the experience of other sectors and other unions and that it has not had the impact that we had perhaps hoped.

[45] **Alun Davies:** I am interested that you used the word 'ethos' in discussing the place of staff in delivering public services in a privatised environment, shall we say. I put a similar point to the Confederation of British Industry when its representatives were here to give evidence before Easter. It was very forceful in saying that that was a very insulting point of view. The CBI director used the example of the BUPA hospital in Cardiff and asked whether nurses there were any less caring than the nurses down the road in the Heath hospital. His view was that people who are working at the sharp end of delivering public services, no matter what the ownership regime or the financial underpinning of it, are excellent and delivering excellent services. He found the whole concept that this public service ethos can only exist in the publicly funded sector, to be quite insulting to those who work in PFI projects.

[46] **Mr Galligan:** To answer that, 'He would say that, wouldn't he?' You need to speak to the people who are doing the jobs—those who are on the minimum wage, a poor pension and who might have contracts for 10 or 11 hours a week because it is easier to have 15 people on those types of contracts than to have people working a greater number of hours. The ethos disappears—the motive is profit. That is the contractor's business, and I am not saying that it

should not be doing it, but the contractor's ethos is, 'I want it clean, at a minimum cost, to a standard that I find acceptable'. It may not be the previously acceptable standard and it is for the purchaser to decide whether or not it is happy to accept a lower quality, but lower quality often does follow the transfer of services. However, we would not accept that a public service ethos does not exist. Most public service workers would tell you that it very much does because many people working in the public sector could earn more money outside, but do not choose to do so because there is a value in working for the public sector. That is not so much about job security or pensions. People have personal values that they often bring to the job.

[47] **Mr Walker:** The other point that the CBI might have mentioned to you is that Wales would be closed for business if we shut up shop to PFI. We certainly do not accept that point. You have heard from the Welsh Local Government Association that many of its contracts are given to the private sector and that many things such as road building cannot be done in-house. It is obvious. We still attract high levels of foreign direct investment to Wales. That does not suggest that our nation is closed for business, so we refute those arguments.

[48] **Alun Cairns:** I know that that is something that Oscar wants to discuss.

[49] **Mohammad Asghar:** In the second paragraph of your submission, you say,

[50] 'The UK Government claims that PFI provides better value for money than conventional procurement. In particular, PFI schemes are held to be better at delivering infrastructure on time and on budget.'

[51] I am sure that some of your colleagues work with and for the Government, but it has not suggested a low uptake of PFI in Wales. Derek just mentioned the view of Wales being closed for business or a no-go area, so what impact is that having on the public sector and on potential contractors?

[52] **Mr Walker:** As I said before, we do not accept that argument. I think that others have said the same to you. There are factors that mean that we are not as successful economically as other parts of the UK in terms of the start up of new businesses, investment in skills and training and higher reliance on certain industries in decline—all those sorts of things. It is a more complex picture than to say—

[53] **Mohammad Asghar:** Tell us, as lay people, what your views are on this. We are asking what the public sector and the potential contractor think about PFI. Do you think that this is the best way forward for your Government?

[54] **Mr Walker:** The TUC is a cross-party organisation, so it is not our Government.

[55] **Mohammad Asghar:** I am talking about the British Government, which is funded by the unions.

[56] **Ann Jones:** I am sorry, Chair, but that is not—

[57] **Alun Cairns:** Hang on a minute.

[58] **Mr Galligan:** I can only present Unison's point of view. We have been consistent in our argument with the Labour Government in Whitehall since 1997. Regardless of who is delivering PFI, our policy existed before 1997. In reality, before 1997, there was very little experience of PFI. We have consistently argued throughout the process that if it was wrong then, it is wrong now, but based on experience. We are not supportive of a different plank or a different policy in England than in Wales; we feel that it is wrong in England as well as in Wales.

[59] **Alun Ffred Jones:** Am I right in thinking that your main concerns about PFI contracts are about the effect on the staff, rather than the gains or losses in the contracts themselves?

[60] **Mr Galligan:** We are a trade union, and our first interest is the interests of our members but our second interest—and it is in the Unison statement of values—is that we want value-for-money public services, and that comes from a valued workforce. It does not necessarily mean that we do not have to recognise that other real politics is wider than just staff; we do not believe that there is value for money from PFI because it has never been evidenced. There has never been an open debate about what it really costs. I know that part of this committee's work is to get into that evidence, but we are talking about Wales and not the UK debate.

[61] **Alun Cairns:** So, you do not believe that there is value for money to be gained from PFI in any way. For example, a school in Maesteg had huge structural issues that the private sector contractor had to resolve, which cost it over £1 million to resolve, which left it out of pocket to that degree. Do you accept that that was a pretty good deal for the taxpayer?

[62] **Mr Galligan:** It depends on what it is costing us for the rest of the life of that particular contract. If the contractor has to remedy something that was principally its fault—

[63] **Alun Cairns:** No, it was a structural issue that neither the public sector nor the private sector had foreseen at the outset.

[64] **Mr Galligan:** Are we talking about PFI here?

[65] **Alun Cairns:** Yes, and it will end up in a huge loss for the private sector contractor that provided it.

[66] **Mr Galligan:** If it did end up paying the tab, it would be one of the few contractors that has done so. If you read the evidence that we have presented, every time something goes wrong it seems that it is the public sector that picks up the tab, whether that is for a failed computer project or whatever. There is a quotation in our evidence from a Labour Westminster Government Minister that the Government does not want to frighten off the private sector. I am not saying that that is helpful, but an isolated incident does not justify an entire policy.

[67] **Alun Cairns:** Point taken.

[68] **Jenny Randerson:** Following on from that very neatly, when the Auditor General gave evidence to this committee he stated that the economic costs of PFI/PPP

[69] 'are broadly similar in amount and timing between private finance and public finance. There are long-term financial costs in private finance deals, but so there are with servicing government borrowing to finance public capital investment.'

[70] That is the view of the Auditor General, which contrasts with your view that PFI results in the accumulation of increased levels of debt for the future. I wish to ask Derek Walker specifically about this, because that was the view in your paper.

[71] **Mr Walker:** Yes, absolutely. We do not believe that PFI offers value for money, and the Unison paper—which Cardiff University put together—goes into more detail and it talks about not having the facts about how this case is made in terms of the risks. We do not get all the information and we are not able to see all the information about how the comparisons are

made in terms of the public sector comparator compared with the private finance initiative option. The profit, the cost of consultancy and legal fees, the increase in private sector borrowing costs, and any additional costs for having to change the service requirements during the life of the project mean that PFI does not offer value for money in our experience, compared with traditional procurement methods.

10.40 a.m.

[72] **Mr Galligan:** The quotation from Jeremy Colman in the Unison paper is that it is ‘pseudo-scientific mumbo-jumbo’.

[73] **Alun Cairns:** I think that that is quite selective. If you read the whole of the quotation, you would find that it offers a bit more information.

[74] **Mr Galligan:** That entire paragraph is about costs and value for money—the quotation is from 2002—and he is demonstrating there that a level playing field is not used when these risk assessments are made. He is covering the risk transfer in that section. The last sentence is particularly interesting. He says:

[75] ‘the answer doesn’t come out wrong very often’.

[76] That is because if it comes out wrong, you do not get the project.

[77] **Alun Davies:** On the public sector comparator, Mr Walker, the TUC written evidence says:

[78] ‘The comparison between the PFI/PPP scheme and a (usually) hypothetical public sector comparator is subjective and often has built in assumptions that favour the privately funded scheme’.

[79] Could you explain what your concerns are with these models and could you give us examples of where you feel that the models have unfairly affected the publicly funded options?

[80] **Mr Walker:** Could you repeat the question?

[81] **Alun Davies:** In your written evidence, the second paragraph under the title ‘Public Sector Comparator’ makes a point about the comparison between a PFI or a public-private partnership scheme and a hypothetical, let us say, public sector comparator being subjective. It says that it,

[82] ‘has built in assumptions that favour the privately funded scheme’.

[83] What do you mean by that? Which assumptions favour the privately funded scheme and why do you think that the comparison that is made is unfair to the public sector?

[84] **Mr Walker:** This comes back to the risk issues. You have to make assumptions, guesses and hypotheses around what the risks are. That research and the experience of others show that these risks are made to fit so that the PFI model comes out more favourably, because it is seen as the only show in town.

[85] **Alun Davies:** Could you give us more detailed written information on this? Perhaps you could write to the clerk to explain in a bit more detail what you mean by that, because it is a fundamentally important issue in terms of the comparison between PFI, for argument’s sake, and a traditionally procured project. Something like infrastructure is fairly

straightforward. If these models have, built into them, assumptions and means by which the public sector is almost deliberately and consistently treated unfairly, we need to understand what those models and failures are. So, it might be useful if you could give us written information on those and examples of where you think that the public sector has been treated unfairly. Would that be possible?

[86] **Alun Cairns:** That would be useful.

[87] **Mr Walker:** I am more than happy to do that. We will submit the information to the clerk in the usual way.

[88] **Alun Davies:** There are a few areas in your written submission where you make assertions but do not provide examples to sustain those assertions, and it might be useful if you also provided us with additional written evidence on that. I am thinking particularly of the third paragraph in that section, where you say:

[89] 'There is no clear evidence yet, either way, that bringing in the private sector will improve poor services. There is evidence, however, of major problems and service failure'.

[90] You do not provide examples of that evidence. It would be useful to see that evidence. In the next section, on the experience of staff, you say that,

[91] 'The rationale for staff to be transferred into the private sector is for future savings'.

[92] Where staff have suffered as a result of these transfers, it is important that we see those examples, so that we know and understand what we mean and what we are talking about when we talk about a reduction in the terms and conditions of employment for staff.

[93] **Mr Walker:** Absolutely. We are happy to do that. We have not done that because we know that you have had detailed submissions from individual unions, and our paper was attempting to cover, in broad terms, the key points made by those unions. I guess that we will end up picking up some of the examples from the papers that you have already received from individual unions to illustrate these points. There are already examples of the points that you have picked out in the Unison paper. However, I will be more than happy to bring all that together if that is useful for you.

[94] **Alun Cairns:** Any additional information would be useful, rather than replication of what we have previously heard.

[95] **Alun Ffred Jones:** You list in your evidence a number of examples of failures, as you describe them, from the Baglan Hospital case. Yet, the evidence that we received from the trust states plainly that the service specification still delivers and that it receives excellent feedback from its patients and staff. Do we believe you or do we believe the trust? It is the trust that is running the hospital.

[96] **Mr Walker:** Believe us.

[97] **Alun Ffred Jones:** Why?

[98] **Mr Walker:** These comments come from the staff representatives. I do not know where the Baglan Hospital management heard the staff feedback that it has given you—whether that was in meetings with staff or not—but I have not seen that evidence. However, this comes directly from a Unison representative who represents staff at the hospital.

[99] **Alun Ffred Jones:** It seems odd that the trust seems happy with the arrangement and with the way that the contract has panned out. Have you been in detailed negotiations with it over the years?

[100] **Mr Galligan:** I know that Paul Williams of the trust is an advocate for PFI. I have no doubt that he has a new hospital as a consequence of PFI, but this is not being selective or subjective. There have been any number of problems with the cleaning services there. The trust now has to put more extensive extra funds to ensure that there is an adequate cleaning service. That is a fact of life.

[101] **Alun Ffred Jones:** Would the problems have come to light even if it had been built in the traditional way?

[102] **Mr Galligan:** If it had been built in the traditional way, the cleaning contract element would have been factored in according to the standards that were operating across the rest of the trust. The main PFI contractor is Kier Project Investment, and the subcontractor delivering the cleaning services is OCS—the chain gets longer—working to a specification agreed between it and Kier, not agreed between it and the trust. As a consequence, there have been three separate disputes at that hospital over attempts to reduce cleaning quality, cleaning frequency and cleaning standards. The trust has had to put extra money in to maintain or improve the standards to the same level as is enjoyed across the rest of the trust. Hospital-acquired infections are a priority area for the trust.

[103] **Alun Ffred Jones:** Extra money has been put into the contract.

[104] **Mr Galligan:** Yes, extra money has been put into the cleaning contract by the trust.

[105] **Alun Cairns:** We are grateful for the evidence that you have given, but Mr Williams stated categorically to the committee that he was not in favour nor against PFI and that he was giving evidence as a manager running a PFI hospital. You asserted that Mr Williams was pro PFI, but I wanted to put on the record what he told the committee. I do not know whether you have further information—I do not particularly want to make this a discussion about Mr Williams—but it is important to put the record straight.

[106] **Jenny Randerson:** I want to clarify the issue of extra money from the trust. My local trust has put extra money into the cleaning of the University Hospital of Wales, but there is no PFI involved; it is the contractor, and the trust has been carrying out Government wishes. Therefore, are you specifically saying that the trust has put in extra money into cleaning, over and above the money that it has put into cleaning the other hospitals that it runs, at a higher level?

10.50 a.m.

[107] **Mr Galligan:** My understanding is that it had to put extra money in to bring the standard of cleaning up to that which was enjoyed across the rest of NHS Wales.

[108] **Alun Cairns:** Could we ask you for evidence of that? I am conscious that, only a few years ago, the Audit Committee studied a report on hospital cleaning, which somewhat contradicts what you said. Therefore, any evidence that you can give would be useful, and we can then reconcile it with the hospital.

[109] **Jenny Randerson:** Maybe we could write to the trust as well—that would be helpful, to decide what the issue is.

[110] **Alun Davies:** It would be useful because we have heard conflicting evidence on

Baglan Hospital; I feel that that is dominating my thoughts at present. We had a good evidence session with the Baglan Hospital management; a week later, there was a report in the *Western Mail* that directly contradicted the evidence that we received in committee. Since then, we have received from the unions, and, to be fair, from elsewhere, other contrasting evidence about the success of that model. It might be useful if we were to revisit some of the issues.

[111] **Alun Cairns:** That is useful. However, in fairness, the *Western Mail* article was a simplistic approach to it. I have not covered that question, so I will do so now, and this comes back to the evidence that is presented in the paper. You present a comparison, and you state in your paper, that PFI projects in Wales are five times their capital value. That was the basis of the evidence that was provided in this article in the *Western Mail*. Is this a fair question, and a simplistic approach, bearing in mind that PFI includes other factors in addition to the project's capital value? For example, I will go back to the Bro Morgannwg NHS Trust example, where the lifts needed replacing at the Princess of Wales Hospital, at a cost £2 million; if that had happened in Baglan Hospital, it would not have been an issue for the trust, because it would have been replaced by the private sector. Those maintenance issues are built into the costs, so is it fair to say that the capital costs are five times their value?

[112] **Mr Walker:** That was in our paper, and it comes from a Committee of Public Accounts report. Therefore, I believe that it is fair to say that, because those are the facts as we understand them.

[113] **Alun Cairns:** But do you not accept that a PFI arrangement would usually have other factors built in that would make up that cost?

[114] **Mr Walker:** Absolutely, but this goes back to our points about the public sector comparator, compared with PFI. I can go through the points that we have made, about why we do not believe that those are fair comparisons.

[115] **Jenny Randerson:** Earlier on, we discussed the alternatives. The simple fact is that, in Wales, we have much less flexibility than that enjoyed by the UK Treasury, because we have a specific sum of money. We cannot borrow, and we cannot do what the Scottish Parliament can do, namely increase taxes, so we have no alternative to the total sum that we are given. Given that financial scenario, and given that the UK Government allocates us our capital moneys on the assumption that PFI will be used, because that is the model that is used in England and Scotland—it is even more popular in Scotland than it is in England—what alternative to PPP do you advocate for the Welsh Assembly Government, in order to have available the amount of capital that needs to be spent?

[116] **Mr Walker:** To go back to the beginning, I believe that it is fair to say that we would prefer there to be more flexibility in public sector borrowing, as well as progressive taxation—I know that it does not exist, but it is important that we put that on record. As I said earlier, we have not come out in favour of one particular option. What we have said is that the impact on services and staff, and on value for money needs to be considered. There are options that are better than PFI—namely, if they do not transfer staff, and do not have a profit incentive in the way that PFI does—but we have not come out in favour of any particular option. So, I am not able to answer that in as direct a way as you were looking for, perhaps.

[117] **Alun Cairns:** Mr Galligan, do you have anything to add?

[118] **Mr Galligan:** Our concluding paragraph states that we need this debate on future provision. We are not hiding from the debate; we welcome it, and it needs to take place. It is not for us to argue about how the budget is spent across Wales, though I am sure that that goes on, probably even around this table. Everyone will have demands and expectations, and

you cannot always meet both. It needs a debate, and we are not hiding from the need to have the debate. I suppose that I could end up with egg on my face were we to have the debate and were it to turn out that PFI provided wonderful value for money. However, if we can provide evidence for that, let us do so. We have consistently argued that there is no transparency about any of the evidence to allow us to do that work. I suspect that, even within the difficult sessions that you may have had as a committee, the areas that you have yet to really get into are those that are still shrouded in commercial confidentiality. That is, how much is being made making on PFI projects.

[119] **Alun Cairns:** Alun, I know that you wanted to pursue the transparency issue.

[120] **Alun Davies:** Yes. You say in your evidence, Mr Galligan, that one failure of the PFI model is what you describe as a 'transparency deficit', and that data on costs and methodology have been kept out of the public domain on the grounds of commercial confidentiality. Looking at this from a positive point of view rather than using that to dismiss PFI as a concept, how would you suggest that we remedy that? We have PFI schemes at the moment, and they have issues, and, to be fair, it is perfectly reasonable to allow private businesses to maintain commercial confidentiality. Therefore, how do you suggest that we remedy the public deficit—the democratic deficit, if you like—that is created by our inability to hold some businesses to account unless we have the information that enables us to do that? Do you have any positive suggestions to make on how we could deal with that?

[121] **Mr Galligan:** A key area that reinforced the absence of transparency in this process—and I think it is referred to elsewhere in the paper—is that the number of bidders for PFI contracts has reduced, and the vast majority now have just two bidders. Far be it from me to suggest that we go back to the 1970s, when we lived in a world of construction company cartels, and it was described at that time as 'price-fixing'. I am not saying that it is a comparable model, just that it was also created in an environment of no real competition. If you have only two people bidding for a PFI project, the issues of commercial confidentiality become more critical to them than to the public sector.

[122] Whether the committee has the power to examine a PFI arrangement retrospectively, I have no idea, but I would have thought that there are recent examples of PFI projects in Wales. Can we not critically examine how the contract documentation was devised, how it was awarded and how risk was assessed, or, indeed, whether it was just a cosmetic exercise? I would like to think that it was not, because I am a taxpayer, but I am not naïve, and it would not be the first time for the Government to pay over the odds for something. If we had the transparency, and someone could show me evidence of it, I would have egg on my face, would I not? I am here saying, 'We cannot sustain the arguments any longer', but someone needs to produce that evidence. We can produce evidence to support the other side, to say what it normally costs as a public sector feature, as long as we are using the same benchmarks, and the same level playing field, but we do not think that that has been the case. If no-one comes up and says, 'This is how we did it', we will just have to make assumptions.

11.00 a.m.

[123] **Alun Davies:** May I go on to a different subject? In your written evidence, Mr Galligan, you talk about projects being on time and on budget. You dismiss the Treasury's evidence that, of the 451 PFI projects that were operational in 2003, 88 per cent came in on time or early, with no construction cost overruns. The Treasury contrasted that with the 70 per cent of non-PFI projects that were delivered late and the 73 per cent that ran over budget. You also dismiss the evidence from Gary Sturgess of the Serco Institute that one of the successes of PFI projects is that they are delivered on time and on budget. From a personal point of view, I think that one of the only arguments in favour of PFI is that projects tend to be delivered on time and on budget. I am interested, therefore, in the fact that you dismiss the

evidence from the Treasury and others that an advantage of PFI is the delivery of public assets or services on time and on budget.

[124] **Mr Galligan:** I do not think that I dismissed it; what I think I actually said was that I was not going to defend the fact that public sector builds have often come in badly behind time and over budget. It may not have happened in the recent past, because we have not had that many, but it is certainly a fact of life. I accept that it is because—and I think that I also said this at the beginning—we do not have the necessary expertise in the public sector. Perhaps it is that expertise in project management to bring it in on time and on cost that we need as public-private partnerships. We do not employ our own contractors, and you have to use the construction industry. It is not a question of there not being a relationship; I just do not think that projects have ever been well managed in the public sector so that delivery is on time and on budget. To get that right, maybe that is what the public-private sector relationship needs to focus on. I do not think that I dismissed the Serco Institute. I think that the paper is fairly dismissive of it, because the Serco Institute, after all, is a private contractors' company, and I would expect it to speak out very strongly in defence of its industry.

[125] **Alun Cairns:** Thank you. Before I move on to Ann, who has the final question, I want to ask a question, Mr Galligan. In your paper, you mentioned risks about the refinancing of PFI projects, and that has come up a few times during the discussion. May I give you an opportunity to expand a little on that, and on what you see as the key risks for service delivery and potentially to personnel and others?

[126] **Mr Galligan:** On risk transfer—I am starting to sound like an expert, but I am not. As I understand it, the risk with a PFI project is during the construction phase, which is again to do with the on-time, on-budget argument. That is the primary risk, but this is about what happens when that stage has been passed, and we understand that. I think that the one example that has been quoted frequently is that of the Norfolk and Norwich University Hospital, whereby the PFI consortium refinanced the deal after the construction stage and made substantial profits, effectively, by selling the PFI on. It is refinancing. Norfolk and Norwich springs to mind, because I think that that was the first of what were deemed to be innovative actions.

[127] **Alun Cairns:** I take it that the issue for you, and Unison, is the profit that they would make at that point.

[128] **Mr Galligan:** I have a figure stuck in my mind that they made something like £660 million extra profit just on the refinancing.

[129] **Alun Cairns:** That is the issue for you: the refinancing and the profit that is made, excess profit, if—

[130] **Mr Galligan:** Ultimately, over the 30-year contract, the public sector is still picking up that bill.

[131] **Alun Cairns:** That is useful, thank you.

[132] **Ann Jones:** Briefly, you started off, Dave, saying that PFI was the only game in town but that you would like to see us looking at other models. You welcomed the fact that this committee is starting the debate. You have said that there is a need for a genuine and wide-ranging debate on the different options for the finance of public service infrastructure. Are there any examples of alternatives that you would like to see being considered in such a debate? You could give us a broad-brush outline now, and provide us with a little more detail at a later date.

[133] **Mr Walker:** I think that it goes back to what I have said before. Perhaps we could submit some additional evidence on that point to the committee clerk.

[134] **Ann Jones:** That would be helpful.

[135] **Alun Cairns:** Okay. Mr Galligan, is there anything that you want to add to that?

[136] **Mr Galligan:** No. It is complex, because we are addressing the current options, and I realise that perhaps we should have spent a bit more time looking at options for the future. Our paper was prepared for us, with internal input, by Cardiff University, and that was not within its brief. Perhaps we will re-visit that, as I would be quite happy to provide that information. If we provide supplementary evidence, you will need to see it.

[137] **Alun Cairns:** As we have said to others, if anyone has any further evidence that they want to provide to us, we will take that on board positively, in the spirit in which it is intended.

[138] I thank you both, Mr Walker and Mr Galligan, for the evidence that you have provided, for the papers and for answering the questions in a candid and succinct manner. We are on time, or thereabouts, so I am grateful for that. We would appreciate it if you would be kind enough to follow up some of those points, as agreed, and, should anything else comes to mind or to your members' attention after this session, we would be more than happy to hear about it. Thank you both for your time.

11.06 a.m.

[139] Ymchwiliad i Bartneriaethau Cyhoeddus Preifat: Enghreifftiau Eraill o Bartneriaethau Cyhoeddus Preifat
Inquiry into Public-private Partnerships: Alternative Models of Public-private Partnership

[140] **Alun Cairns:** This item is, in effect, a brief on the alternative models of public-private partnerships. We are all familiar with Gronw Percy, who is one of the committee's special advisers on this subject. I also welcome Mr Jon Sibson, who has come from the London office of PricewaterhouseCoopers to update and brief us on the latest developments in PFI, as well as the different PFI models that are available. Simon McCann from Morgan Cole is our other special adviser, and we are grateful to him for joining us.

[141] Mr Sibson, I ask you to introduce yourself and your colleagues for the Record. Secondly, could you give us a broad overview of the models that are out there? Some four of five would be good, I suppose, depending on how you split them up—though I am not going to tell you how to do it. After we have had the broad overview, we will try to break each down in turn with questions. We have scheduled about 40 minutes for this session, so, all being well, we will be able to fit it all in.

[142] **Mr Sibson:** Bore da. Those are the last Welsh words that I will be speaking today, I am afraid.

[143] My name is Jon Sibson, and my colleagues are Simon McCann and Gronw Percy. Thank you for this invitation to give evidence and for appointing us as your expert advisers on this inquiry. It is timely to be carrying out the inquiry now, because there is a lot going on in the world of public-private partnerships, and I am sure that you will have had evidence about the potential implications of the introduction of international financial reporting standards, and what that means. In addition, another devolved administration, the Scottish

Government, is having its own quite fundamental and radical thoughts about how public-private partnerships should be implemented in its own jurisdiction, in the form of the Scottish Futures Trust.

[144] I will talk for around 30 seconds about me and my own experience. I run the public-private advisory team at PricewaterhouseCoopers in the UK. I have been doing this on and off for about 14 years, so I think that I have some idea of what works, but I have also experienced and seen a few failures along the way. My first experience, in the latter half of the 1990s, was in Scotland and in Northern Ireland, helping the public water authorities in those jurisdictions to look at schemes for investing in water and waste-water infrastructure. Between 2000 and 2003, I was based in Singapore, looking at these kinds of models in many emerging and developing economies in south-east Asia, so I was looking at ways of getting private finance into quite basic public infrastructure. What is most relevant to this inquiry is that the Governments in Hong Kong and Singapore at that time started following PPP models, which are recognisably similar to those that you find in western Europe. In the past four or five years, I have been working on projects back in the UK, mainly in the environmental sector, but also in urban regeneration, looking from that point of view at schemes that may be relevant to your inquiry where the public contribution comes in the form of assets and land, and not just cash.

11.10 a.m.

[145] From that, I have learnt that, although the principles are often the same, the way in which they are implemented in different jurisdictions varies hugely according not only to underlying differences in need, but also to political culture, what is possible, what is doable, and the places you cannot go.

[146] I will touch on the models in a minute, but first, I will issue a health warning about the whole concept of models. It is sometimes tempting to treat this a bit like the Argos catalogue or *What Car?* magazine, in that you have a list of the models, and you flick through and find the one with airbags and the diesel engine or whatever you want, and that is the model. It can get very confusing, and we hope to bring out in the discussion that the things to focus on are the fundamentals: what infrastructure is needed; what types of infrastructure are needed; what the scale is; how replicable it is; what the sources of finance are; what the best method of procurement is; and what the political and policy constraints are. That must be borne in mind when looking at the models.

[147] We have quite a few wiring diagrams and organograms, but it might help the committee to break those down into four families. The first family starts off with the classic PFI as developed in the early to mid-1990s. It will be familiar to you from the evidence that you have had. You will find an organogram on slide 8. The basic concept here is a contract between the public sector and a private sector provider, under which the private sector provider designs, builds, finances, operates and maintains a facility of some sort—it could be a road, a school or a hospital. It is paid for over time, but conditional on the availability and usability of the asset, whatever it is, and subject to its provision of whatever services are required of it, which could be facilities management services, to specified standards. Those are typically long-term contracts. There are hundreds of examples of such projects.

[148] The first children that that model had are two main programmes called LIFT, the local improvement finance trust model, which is for primary healthcare facilities—you may have evidence about that—and Building Schools for the Future, which is about the re-provision and upgrading of secondary school estates. There are many detailed differences between those models and classic PFI, but I will draw attention to the main points. Slides 12 and 13 are the relevant ones in the evidence here. The main point is that the public sector entity, a local authority, an NHS primary care trust, or whatever it is, is procuring a

relationship with a private sector partner, not just to design, build, finance and operate a single facility—they are entering into a relationship that is intended to last a period of years, covering several generations of assets.

[149] The initial transaction will be for a particular set of primary healthcare facilities, or the upgrading of a particular school, but the concept is always that the public sector and the private sector partner would work together on subsequent schemes, and those subsequent schemes could either be privately financed or conventionally financed—the model is neutral with respect to the two. The other feature of the scheme is that the vehicle for running that relationship—in the case of Building Schools for the Future, it is called a local education partnership; a LEP—has some public sector equity investment in it, which is intended to give a corporate voice to the public sector in future decisions. To sum up, it is a partnership in a corporate sense, and not just a contractual sense. There is public sector investment, and it envisages a programme rather than a single project. We have seen that, as I said, in secondary schools and in primary healthcare facilities. So that is the first descendent of classic PFI to which I draw your attention.

[150] Another example that may be of interest to the committee is the non-profit distributing structure that we have described in slides nine, 10 and 11. That structure has been used in Scotland in some schools projects, for example Argyll and Bute schools with which we were involved. The main difference between this and classic PFI is that the private sector capital comes in the form of debt only—there is no equity. Some of the debt is called, 'subordinated debt', which is a higher risk debt—namely risks akin to those that equity takes—and therefore accrues a higher interest rate than the senior, safer debt. As there is no equity, no-one is legally entitled to the returns from the project once the contractors have been paid and once the debt has been repaid. That is a deliberate feature because those surpluses or dividends go to the community and there are various structures through which that can be done. As I said, there are examples in Scotland of such projects in the area of schools.

[151] It is worth saying that that is not the only model that caps the private sector's profits. There are simpler changes that you can make to the classic PFI model that have the same effect. I am not recommending them, but drawing your attention to them. I mentioned that I had worked in Northern Ireland in the late 1990s, where we worked on a waste water and sewage treatment project for the then Northern Ireland Water Executive, which is now called Northern Ireland Water Limited. It did not want the private sector's returns to be uncapped, so there was something in the payment mechanism that said that above that point—above an equity return of a defined level—it got a rebate on the charges that it had to make. So, that is the second grandchild of classic PFI.

[152] There is a third that I will mention briefly, which is being born right now, namely the so-called 'integrator model', and Gronw will tell me which is the relevant slide.

[153] **Mr Percy:** That is slide 20.

[154] **Mr Sibson:** I will mention it briefly because I think that it is mainly relevant to some large, complex projects and it is being practised mainly by the Ministry of Defence. In this model, the private sector partner—the integrator—is appointed partly to provide services and facilities, but also partly to procure them from other people. It normally happens where there is a complex value chain of different types of assets, services and facilities. So, an example is something called the military flying training service, the output of which is trained military pilots and crew. A contract of that nature is about to reach financial close where the assets provided will involve bricks and mortar buildings for training colleges, simulators and aircraft. The preferred bidder in that case is a consortium called Ascent, which is led by Lockheed Martin and Vosper or VT, formally Vosper Thornycroft. They will partly provide those facilities, but partly help the MOD to procure and manage further training assets and

equipment. I mention that for completeness because it is at home with certain large complex projects that may or may not be what you mainly have in mind. So that is the first family of classic PFI and its grandchildren.

11.20 a.m.

[155] The second family involves projects where the public sector's contribution comes mainly in the form of land or assets rather than in the form of cash in paying a unitary charge. This is a less well defined family of options, so there are not as many obvious wiring diagrams, but I can give you a practical example, which is outlined in slide 16. The example that I will give— and there are others that my colleague Simon McCann can give you later from Wales—and with which I am familiar is the London-wide initiative, which is promoted by English Partnerships, the regeneration agency in England.

[156] The policy problem was the shortage of affordable housing for key public sector workers in London, such as nurses, primary school teachers, and so on, given the frothy housing market in London and south-east England and the shortage of social housing. What English Partnerships had to get the party going were some strategic sites. They were rather sad and tired in their current form, but they were sites where a great deal of value could be created from their redevelopment. English Partnerships ran a competition, the objective of which was to make a bid where the bidder would provide some social housing, some affordable housing, and, to help to fund that from cross-subsidy, some private housing. The scheme was structured to maximise the outputs of affordable and social housing. A programme of 12 such schemes is now being implemented. I draw that to your attention as an interesting example, but similar examples have happened in Wales that Simon McCann might want to talk to you about later. So, that is the second model.

[157] A third model, which, again, is really a family of models—and it is an idea rather than a model—involves prudential borrowing or bonds. Some of the evidence that you have received may have mentioned bond financing. There is sometimes a feeling of alchemy about bonds as somehow being a source of free money. Bonds are merely a form of borrowing, so if you hear the word 'bonds' think of 'borrowing'. Like prudential borrowing, all of these borrowings must be paid back somehow.

[158] The idea that unifies these ideas and gives them purchase is the idea that, with the proceeds of the borrowing—whether prudential borrowing or bonds—you can do something, such as regenerate part of a city, that will generate revenue streams and perhaps increase business rates, which will give you the financial resources to pay back the borrowing. That is the generic idea. There is a clear way of implementing it through prudential borrowing, and that has happened, although not on a huge scale. The types of ideas that we refer to in the paper—the so-called 'Barnett bond'—are innovative and have not yet happened. There are many issues for local authorities about their vires, and there are probably also some conversations to be had with the Treasury about how all of that sits alongside controls on borrowing for local authorities and others. So, that is one amorphous family.

[159] The final model that I will mention for the sake of completeness, although it is not in the paper, is public private partnerships where the asset is funded through charges on an end user. The Severn crossing is an example. I read in a newspaper that there was some discussion about financing the upgrading of the M4, in part or in whole from tolls. There is congestion charging in London, a scheme has been talked about in Cardiff and there is the Birmingham relief road in England. It is an interesting concept. In France, they claim that they invented PFI 100 years before *les rosbifs* because that is how many examples of French public infrastructure has been financed and funded. It is only relevant when there is something for which the end user can credibly be charged, and in our circumstances that is mainly transport of one form or another. So, that is the fourth set of options, which I mention for completeness.

[160] To sum up, I will repeat the health warning about the Argos catalogue. In looking at the models, you should start by looking at the type of infrastructure you want, what financial resources there are, the best method of procuring it and what the political and policy constraints and opportunities are. I hope that I have not gone on for too long.

[161] **Alun Cairns:** Thank you very much; I am sure that it was hard work and that you deserve your glass of water as you must have a dry throat. This is the way that the committee wanted to pursue it. To go back to the variations on the classical model, I have a question to begin and I hope that other Members will seek to clarify their knowledge thereafter. On the Building Schools for the Future model, you talked about it as a relationship. Some of the procurement in this arrangement may be classic PFI and some of it might be traditional procurement. Is there a risk in that sort of arrangement that you are closing down competition? A public sector provider, perhaps a local authority, will not necessarily know, over 30 years, what its demand for primary schools, say, might be: it depends on what the birth rate is. So, let us say that, 10 years into the project, you realise that you need to build a new primary school because there has been a growth in population. On that basis, if you are in an arrangement with a private sector partner, you are stuck with the private sector partner no matter what reputation it may have acquired in the meantime.

[162] **Mr Sibson:** The private sector partner does not have guaranteed exclusivity. If it did, the process would be open to that danger. It has—and I am summarising rather than stating it precisely—a benchmarked right of first refusal but if the benchmarking of the price suggests that it is not offering value for money, the local authority can revert to a separate procurement. The idea is that if you work in a relationship, your provider comes to understand your needs and will have an incentive to give you a better price over time, through continuous improvement. If, when you benchmark, that turns out not to be the case, you can go to another source.

[163] **Alun Cairns:** Is this benchmarking ambiguous and open to interpretation? We have just had evidence from the unions about questions of transparency and we have a session coming up, for example, on the comparability factor between PFI and traditional procurement, and it could be argued that that figure could be skewed to give us the outcome that we want. So, is the benchmark figure potentially open to interpretation?

[164] **Mr Sibson:** Perhaps I could first draw a distinction between the kind of benchmarking that I have just talked about, which is about who will give me the best price for the next school, and the kind of benchmarking that you may have been talking about with your previous witnesses who would probably have been talking about the benchmarking of facilities management services during the life of a contract, which is a much debated topic. The benchmarking of whether the private sector partner would give you the best price or whether you should go elsewhere is difficult to do, but it is frequently done, because you are comparing mainly construction and whole-life costs, which public sector procurers do all the time with the aid of professional advice. It is difficult, but I do not believe that it is uniquely or impossibly difficult.

[165] **Alun Ffred Jones:** You made a point earlier about this arrangement between a private company and a public body in a long-term contractual relationship. How does that fit in with European rules in terms of competitive tendering?

[166] **Mr Sibson:** Are we talking about classic PFI or the Building Schools for the Future programme?

[167] **Alun Ffred Jones:** The Building Schools for the Future programme is perhaps an example that we could use.

[168] **Mr Sibson:** I am not a procurement lawyer—and there is one sitting six feet away—but the layman's answer is that if, in your original procurement notice, you have specified what you are procuring and it is a long-term partnership and everyone has had a fair crack at the whip, then you have not committed a sin. There are, I believe—and I am now right at the edge of my knowledge—limits to the length of framework agreement that you can set but certainly the kind of things that we have talked about in Building Schools for the Future are, if properly done and within the rules, judge-proof in terms of European procurement law.

[169] **Alun Ffred Jones:** It is all right to be at the limits of your knowledge; I am far outside mine. [*Laughter.*]

[170] **Mr McCann:** There are new procurement rules in place so you can have competitive dialogue, which forces competition right up to the final stage on major schemes. So we do not have the old regime that we had of one preferred bidder being able to negotiate what it wanted, more or less.

[171] **Alun Cairns:** I am familiar with competitive dialogue, but do you want to explain broadly what the process is for the record and for members of the public who are watching?

11.30 a.m.

[172] **Mr McCann:** It is easiest to explain it by going back to what the regime was before. We used to have a procedure called 'negotiated procedure' for major projects, whereby we went out to the market, did a first cut of the people who responded, and then we would select one preferred bidder and one reserve—which is what the earlier witnesses from the union were talking about in there only being two bidders involved—and then you will negotiate with your preferred bidder until you reach an agreement and sign the contract. That latter period of negotiation was not always subject to full public scrutiny, transparency, and so on. With competitive dialogue, we still do the first cut, but get down to a shortlist of three. We then negotiate equally with all three, give them all the same opportunity and then take them forward to final bids on the scheme solution that has been identified. So, while you do not get full open competition, you are getting competitive tension between at least three bidders at the final bid stage. So, effectively, you are frontloading the negotiation to before the final bid.

[173] **Alun Ffred Jones:** I am still unclear about this long-term relationship. What examples are there of this setup? What type of contract would this be, and to do what?

[174] **Mr Sibson:** With classic PFI you have a whole range of things, from what you might call hard infrastructure, so there are 13, 14, 15—I cannot remember exactly how many—road projects that the Highways Agency in England operates through PFI, and there are many examples of schools, hospitals—

[175] **Alun Ffred Jones:** I am interested in the long-term relationship. Would these be so that you could roll on to another contract, to another school and hospital?

[176] **Mr Sibson:** No. Sorry, I understand your question better now. The main examples of that kind of relationship are LIFT, the local improvement finance trust, which is a scheme for primary healthcare facilities in England. There are many schemes—I do not know how many—and several times that number of individual facilities. The first schemes under the Building Schools for the Future programme, which is a bit younger, have reached financial close and are now in the course of having the first set of facilities built. So those are the main two sets of examples.

[177] **Alun Cairns:** Are there any more questions on the traditional model or the variations

on the traditional model?

[178] **Alun Davies:** Thank you for your presentation, it was fascinating. On slide 6, you outlined seven different ranges of structures available to us. Over the past six months or so, we have examined many examples that illustrate some of those different structures, but not all of them. From a personal point of view in taking this forward—listening to what you have said this morning and thinking about how to structure this inquiry, particularly with our visits to Scotland and Northern Ireland coming up—I would certainly like us to look in more detail at issues such as prudential borrowing, the Barnett bond and the Scottish Futures Trust/NHS LIFT sort of models, where there is a partnership approach to working. I am particularly interested in looking at some of these models and potentially using them to deliver services that are not being delivered at present. Angela and I work on broadband issues, for example, in mid and west Wales, where there is no broadband delivery to many communities, particularly in rural parts. So, some of these approaches might give us an opportunity to deliver those sorts of services that are not being delivered at the moment, for all sorts of different reasons. I would be interested to look at models and examples of where these different structures have worked effectively. We also need to look at the downsides as well, I accept that, but I would prefer to concentrate more on the positive opportunities and to then take a few of those models forward for further investigation, which would provide us with a greater focus for the rest of this inquiry.

[179] **Alun Cairns:** I appreciate that, but the purpose of this session is to get a better understanding of each model.

[180] **Alun Davies:** I understand that.

[181] **Jenny Randerson:** The Scottish Futures Trust seems awfully like a housing association to me. Have I missed a key issue?

[182] **Mr Sibson:** The Scottish Futures Trust is an idea on the drawing board. I should declare straight away that PricewaterhouseCoopers is advising the Scottish Government on the development of its thinking on the Scottish Futures Trust. That thinking, at the moment, is between us and our client, the Scottish Government, so I cannot go into detail about that. The information that you find in the public domain about the idea of a Scottish Futures Trust is that it is several different concepts running alongside one another. There is something about financing and additionality of financing, that is, ‘Can we do something beyond public borrowing constraints?’, and something about efficiency and cheapness of financing, perhaps from pooling projects. It is also something about not-for-profit. Probably, also, there is something in there about strategic planning of the infrastructure rather than looking at things project by project. So, it is not yet at the stage where you could say that it is like a housing association or not; it is a set of objectives and ideas, and we are paddling like mad under the surface of the pond to try to get a model that delivers as many of those objectives as possible.

[183] **Alun Cairns:** There is an excellent example—sorry, Angela, you had a question.

[184] **Angela Burns:** Thank you, Chair.

[185] Thank you for coming, and for your very illuminating set of slides. On the traditional PFI model, you state that one of the key strengths is that the public sector is offered protection in default scenarios.

[186] **Mr Sibson:** Yes.

[187] **Angela Burns:** You also state that a key weakness is that risk transfer is not always fully effective, so the two seem slightly contradictory. Something that comes over in our

evidence-gathering sessions time and again is the real concern or worry that the risk is not really taken away from the public sector at all. I believe that where there is great profit should be the greatest risk. I would like your view on that.

[188] **Mr Sibson:** Okay. In the interests of candour, we are pointing out that risk transfer is not always fully effective—with bold font for 'always' and 'fully'. To give an example, at the minute, if you were a London commuter, you would probably have strong views on Metronet Rail and the public-private partnership for the Tube. We could easily get diverted for a long time about that. Arguably, what has happened there is that the public sector has picked up some risks that were meant to have been transferred, but which turned out not to be manageable. However, there are clear examples in which the public purse has been very well protected in situations where things have gone wrong. Let us be clear, if you do a lot of large, £100 million capital projects, some will go wrong. So, what happens, and who deals with the consequences? We recently produced a paper called 'The Value of PFI: Hanging in the balance (sheet)?', and we looked at some case studies, including some where things had gone wrong.

[189] A clear example is something called the National Physical Laboratory, which was a facility in Teddington near London, where the contractor found that it was, basically, unable to build what it had agreed contractually to build. That project was eventually terminated, and the private sector participants in that project lost a lot of money. It ended up costing the Government some money as well, but with regard to the money that the private sector contractors lost, if you do a thought experiment, and think about what the distribution of pain and misery would have been had it been conventionally procured, you would find that quite a lot of the pain and misery that fell on the shareholders of Serco and John Laing, as it then was, would have been misery for the taxpayer. Another example is Jarvis plc—I am not sure whether you have had any evidence about Jarvis plc, but it used to be a contractor that was very active in the PFI space—it certainly bid for a number of schools. It overreached itself, and it got into trouble and could not at times complete the projects that it was contracted to build. A financial reconstruction of Jarvis plc took place. It is immensely complicated—there is a case study in our report—but the shareholders of Jarvis plc and its partners in those private equity projects ended up putting their hands in their pockets for a large amount of money to get those schools built.

11.40 a.m.

[190] Again, to undertake a thought experiment, a contractor on a conventionally funded project bids £100 for a project that ends up costing £150 to build, then abandons the project, leaving the public sector with a half-built school on which it has spent around £80; it will usually cost a lot more than originally budgeted to complete the work. In the case of Jarvis plc and the National Physical Laboratory, quite a large proportion of that 'a lot more' is being funded by the private sector shareholder. Real pain has been taken to tackle that and that pain is real protection for the public purse.

[191] **Angela Burns:** I follow the logic of your argument, but we recently heard evidence to suggest that, on the ongoing facilities management part of any large project, the hospital trust or school might have to keep chucking in extra bits of money because somehow, somewhere along the line in the translation of all the contracts and legalities, the risk that the public sector thought that it had shed had come around to bite it again. Do you have any views on how we might be able to protect ourselves more from that? I do not see the point of trying to transfer risk only to find that that does not happen.

[192] **Mr Sibson:** Perhaps you heard evidence about the £300 light bulb.

[193] **Alun Cairns:** We have not heard that; I think that you have dug yourself a hole.

[*Laughter*.]

[194] **Mr Sibson:** I will scamper out of it. There may be two points at play there. The first point that we have just been discussing is whether, when you transfer risk, it comes back on a piece of elastic. What experience and grey hair tells one is that there are some risks that are unmanageable by the private sector, arguably the Metronet-type risks; in which case, whatever the piece of paper or contract says, the public sector will end up paying, somehow. So, it is a question of being clear about the nature and manageability of the risks. If you think that the private sector can manage those risks, and be robust about doing so—evidence shows that the private sector can manage construction risks on most projects—it is sensible to transfer those risks. Experience shows that, when you transfer those risks and things go wrong, shareholders take a great deal of pain that would otherwise have been transferred to the taxpayer. That is debate number one.

[195] Debate number two, which you may have heard earlier, is that it can be quite difficult to define your requirements in a contract in a way that is stable and precise over 25 or 30 years. You will change your mind about some things, so you want a system for agreeing contractual variations whereby the payment is fair and reasonable. You may have heard something about that because, a few months ago, a report by the UK National Audit Office, specifically in England, gave rise to headlines about the £300 light bulb, where some public sector clients felt that they were held over a barrel when agreeing contract variations; they were overpaying for simple things and were saying to themselves, ‘I wish we had retained responsibility for that part of the project ourselves’. That is certainly a problem when it does arise, but I do not think that it is endemic. It is about getting better at defining the change and variation procedures in contracts. We are progressively improving that kind of thing as we go into our second decade of PPPs.

[196] **Mohammad Asghar:** Thank you for your precise briefing. You have provided information on Singapore, Hong Kong and France, but you have not mentioned the biggest growing part of the world in the last 20 years, namely Dubai. That part of the United Arab Emirates has mostly been developed with private sector investment. I am sure that you will be involved with that. That country is a magnet for developers from all over the world, so why can we not do the same here?

[197] **Mr Sibson:** Dubai in Wales.

[198] **Mohammad Asghar:** Yes, they have developed quickly—in 20 years.

[199] **Alun Cairns:** May I add to that? What models will they have pursued in Dubai?

[200] **Mr Sibson:** I cannot claim to be an expert on the economic model in Dubai, but it has a very wealthy ruling family that realised that the money was running out, so it decided to fund the place through property development. It seems to be a good place to have winter holidays, and that type of thing helps; it is also in a good time zone, and so on. Interestingly, in the Gulf states, there is now interest in social infrastructure and public-private partnerships, and last year we seconded someone to Abu Dhabi to develop such a business. You will find that a number of our competitors have done the same. So, there is some interest there in PPPs—

[201] **Alun Cairns:** So, are you saying that, to date, the situation in Dubai has not developed through PFI?

[202] **Mr Sibson:** Yes; it had a fundamentally different set of economic opportunities.

[203] **Alun Davies:** Going back to the examples that you have mentioned, such as Jarvis,

and the issues in Teddington with Serco, is it fair to use those examples? Those examples owe more to management decisions than to financial models—it was Jarvis as a company that failed rather than the financial model that failed, in totality, in terms of the public procurement models of which it was part at the time. I am aware of the example of Serco in Teddington, which was a failure of local management rather than the totality of a business—Serco continues to grow. My concern is what we are seeing developing—you mentioned that we are entering into the second decade of PPPs. Over the past decade, we have seen the development of a very successful secondary market in PFI rights, and so on. That tells us that, overall, we can pick up on examples of individual projects' failure, for reasons of local management, or for other reasons, but, when you look at the market in its totality, you have a very successful market. The issue that I have is that it has been largely funded by the taxpayer. If it is so successful for the city, it cannot be at the same time successful for the taxpayer, because those profits come from somewhere.

[204] **Mr Sibson:** We could get into some deep waters in that regard. People have made profits, but what are profits? Economically, they are a reward for taking risk. You want people to take risks because you think that the private sector is better at managing a particular type of risk than the public sector has been. If you transfer a risk for which that is not true—if you were to transfer a risk which the private sector cannot manage—you are making a mistake, and, as we discussed earlier, the risk will probably boomerang back to you. If you are genuinely transferring a risk, people will want to make a profit out of it—otherwise they would not take the risk. The question is whether or not the risk is excessive.

[205] **Alun Cairns:** I do not think that that is a fundamental question on PFI. The purpose of this item on the agenda is to get a better understanding of each model. We have received evidence from both sides on the PFI model, and if you have a question relating to each model, that is fine, because that is the purpose of this item.

[206] **Mr Sibson:** We will have a drink later, Alun.

[207] **Alun Cairns:** Yes. As Alun said, it is the type of subject that you can discuss over a bottle of whisky.

[208] **Angela Burns:** On community-interest companies, it says in your evidence that:

[209] 'On wind-up or redemption of shares, members can't receive more than they paid for shares'.

[210] I understand that, but it also says that:

[211] 'Profits must (subject to capped dividend) be retained'.

[212] What happens when you wind-up one of these companies? What happens to the money that is left? Where does it go?

[213] **Mr McCann:** It is very similar to the wind-up of any other company. First, you must pay off the creditors—the statutory creditors' revenue, and so on—and your employees. As I understand it, what happens to what is left is that it must be distributed at full market value and, if not, it has to go to another community-interest company or similar provider, so that the assets do not get dissipated out into the wider world; they are retained in the community benefit sector, if you like.

11.50 a.m.

[214] **Angela Burns:** This scheme is very good but it is one of those that, when you start it,

you cannot end. It is a forever scheme. You could not use it as a tactical tool to get money for a particular project.

[215] **Mr McCann:** We were talking earlier about return on equity and so on, and there are advantages and disadvantages to this. It is a disadvantage because it is less attractive to private investors for that reason, although there is a possibility of a limited dividend. The advantage is that, like a charity, housing association or similar body, the assets are retained within that body and are protected by the regulator from being dispersed.

[216] **Alun Cairns:** I want to pursue the issue around the housing collaboration and the Grŵp Gwalia model. That seems to me to be less political in terms of issues, because you are transferring assets with, perhaps, an asset that needs investment. Is that pretty widespread across the UK—the Grŵp Gwalia model has been highlighted here and, from my understanding, as a Member who covers the area where Grŵp Gwalia operates, it seems to be working very well and is a very good model—or is it unique to some pockets?

[217] **Mr Sibson:** The idea of the public sector's putting an asset into a project and getting someone to improve the asset is quite common. It is hard to give an inventory or a number because many of these local-authority-based schemes, which are usually town-centre redevelopments or regenerations, are not reported to the Treasury or counted, so they just go out there. A more definable category of schemes is what you might call state-based regeneration schemes. The Department for Communities and Local Government in London might even have some data on that.

[218] **Alun Cairns:** I was going to ask that. Newport Unlimited comes to mind. Is that what that is?

[219] **Mr Percy:** There are examples in Wales of this type of structure being used for regeneration: the WDA in its previous guise would have used it and the Land Authority for Wales would have had a similar remit in that some of its activities were a variation on a housing or a local asset-backed vehicle model, effectively. The public sector puts in land, the land is redeveloped and you are looking at maximising the gain. What is happening in this area, particularly in England, is that it is being used more and more, particularly with the social and affordable housing scenario. It is fairly widespread. There are variations of it in London and there are schemes in Manchester and Middlesbrough. The model is tweaked and played around with to reflect the economic circumstances of each of those jurisdictions, but the principles are very common.

[220] **Alun Cairns:** I would say that SA1 in Swansea, for example, sounds like that. SA1 and Newport Unlimited fit into that sort of model. It seems to me that, because you are dealing in assets rather than cash, in many ways, it is a less political issue in general.

[221] **Mr Sibson:** What we often see is that the schemes get their value from a mixture of sources. Let us say that a 1960s housing estate needs knocking down and rebuilding or needs to be partially knocked down and refurbished. The value can be from the sales value of any private housing that you put on the estate. It could be from housing corporation grant, in the case of England, to subsidise some of the social housing and, sometimes, you even find these stirred in with a stock transfer scheme and the funding support that that attracts. So, it is about looking at an individual estate and seeing what you need to make the economics work and then the public sector has choices to make. Sometimes, it will want more social housing rather than less, which means that there is less private-market housing available to subsidise the whole project. So, it will need more from the housing corporation or somewhere.

[222] **Alun Cairns:** Or more land, or whatever.

[223] **Mr Sibson:** Yes, so there are a variety of issues.

[224] **Mr Percy:** There are examples of this type of model being used in Wales, but it is really about giving it a wide application and looking harder at the full scope of what you want to run in your competition, to maximise the value to the public sector. It is also about ensuring that the public sector does gain from the potential redevelopment gains, and about creating a more formal joint-venture or partnership structure to capture that.

[225] **Alun Cairns:** That is really useful. Does anyone else have any questions on the models and issues that we have discussed?

[226] **Mohammad Asghar:** None of the PPP or PFI models have come to a conclusion yet, so we cannot look at the final results and say, 'This one is good, this is one very good, and this one is very, very good'. The information that you are giving us at present is about ongoing concerns rather than the final result.

[227] **Mr Sibson:** That is a fair point. The evidence is still emerging.

[228] **Alun Cairns:** Would you like to expand on that?

[229] **Mr Sibson:** I can. Many hundreds of projects have been through their construction phase, so there is a good body of evidence on that phase, and there is an important report by the National Audit Office from 2003, which may have been referred to you, about what happens during the construction phase of PFI projects and how that compares with conventionally funded projects. A smaller number of projects are well into their operational phase, and so there is some research on that. Some research was published by the Treasury in 2006, and we can send you a note including the references to them, if that would help. It is a fair point that evidence is still growing. You will not know whether something that was meant to have benefits for 30 years has succeeded until you reach year 31, by definition. However, there is a growing body of evidence, particularly about the early stages of projects. For the construction phase, the NAO report from 2003 is striking in its contrast between the on-time, on-budget completion rate of PFI projects and conventionally funded projects.

[230] **Alun Cairns:** Time has beaten us. We have gone slightly over schedule, but I felt that it was worthwhile to explore some of those models. The last question was pretty fundamental to everything, was it not? Thank you so much, Mr Sibson, for the evidence that you have given us, the time that you have spent with us, and the papers that you have provided. We are grateful for them.

[231] I ask Gronw Percy and Simon McCann to stay for the next item on our agenda. Before we move on, Alun, I was going to raise the issue about Belfast and Edinburgh that you wanted to discuss.

[232] **Alun Davies:** I wanted to have a private conversation about that.

[233] **Alun Cairns:** Sorry, I did not realise that. I thought that you wanted to raise it here, but that is okay.

11.58 a.m.

Ymchwiliad i Bartneriaethau Cyhoeddus Preifat: Methodoleg ar gyfer Cymharu Opsiynau
Inquiry into Public-private Partnerships: Methodology for Comparing Options

[234] **Alun Cairns:** The next item on the agenda relates to the methodology for comparing options for ‘a hospital’, wherever that may be. We had basic debates about this at the beginning of this discussion, and I think that we almost got into it a little earlier, namely that a PFI project costs hundreds of millions of pounds, while traditional procurement would cost tens of millions of pounds, so it is like comparing apples with oranges, rather than apples with apples. You have given us a paper. Can you both give us an overview of the steps that are followed there, and then answer any detailed questions that we have, to get a better understanding?

[235] **Mr McCann:** This is mainly Gronw’s work, as it is mainly a figures-based exercise, so I will have little input on it.

[236] **Alun Cairns:** That is fine. We will forgive you, this once.

[237] **Mr Percy:** We prepared the paper in response to requests from the committee for a better understanding of how the value-for-money aspect of PFI is judged. We have tried to provide a working example of how the numbers can be shown. Essentially, a fairly tried-and-tested route is followed, using assessment methodology agreed with the Treasury. There are some key stages, and I will talk about each in more detail in a minute.

12.00 p.m.

[238] The first is the assessment of the PFI charge, which is usually derived through a competition. You select your PFI bidder and you get the PFI charges. You then need to find something to compare the PFI charges to, which is called the ‘public sector comparator’. Therefore, a raft of work is done to build up the relevant public sector comparator, so that you ensure that you compare apples with apples. They are then put through a financial model, looking at the figures provided for each side, and you derive an end result, in effect.

[239] When looking at the PFI unitary charges—the PFI process—you look at the period, you run a tendering competition, as Simon described earlier, and you arrive at a figure. What you need to analyse then is what has gone into that PFI figure. If you have a build, you look at the specification of the build, and at what services and maintenance are to be provided as part of the PFI contract. Those will give you some yardsticks.

[240] One big thing that usually happens is that people looking at a PFI contract end up with unitary charges. So, the payments are payments once the facility becomes operational, so there is a series of annual payments. Those annual payments are normally inflated each year—by inflation—and it is in the contract for that to happen. So, often, the first thing to happen is for people to look at the total value of the unitary charges. In the example given, the total value of the charges is about £445 million, but those are inflated numbers. So, in working any comparison, you need to ensure that you deflate those into today’s prices, or the prices relevant to the time.

[241] **Alun Cairns:** May I interrupt you there? Let us take an example of a unitary charge: facilities management costs, for example. The private sector provider would anticipate the cost over the period of, say, 25 years?

[242] **Mr Percy:** Yes.

[243] **Alun Cairns:** Would they build inflation into that, or is a variable inflation rate provided as the cost is drawn down thereafter? Otherwise, that is a hell of a risk—both ways.

[244] **Mr Percy:** The contract will specify the inflation assumption for the components of the cost, and that is part of the contractual negotiations. In most instances, it tends to be RPIX—retail price index—inflation with periodic benchmarking reviews, so your facilities management example would need to be benchmarked. As Jon said earlier, every five years, you would ensure that that rate was still a market rate.

[245] **Alun Cairns:** I appreciate that, as a comparator, if inflation hits 15 per cent, the comparator cost could be the same for the public sector and the private sector. So that I can understand the process, if the taken rate of inflation is 4 per cent at the time of the agreement, but inflation in 10 years' time hits 15 per cent, would a review period be an option, to apply that to the cost?

[246] **Mr Percy:** No, because the contract would state that it would be based on the RPIX—the prevailing inflation rate at that time. So, it is increased each year. Each year, if the contract charges go from April to April, for example, you would look at the inflation factor in February, and say, 'This is the RPIX inflation rate in February, so the contract is inflated by that rate'.

[247] **Alun Ffred Jones:** So, is that invariable then?

[248] **Mr Percy:** Yes. What happens when you do the original comparator is that the inflation factors that are used are gleaned from the Treasury data of forward inflations.

[249] **Alun Ffred Jones:** So, is the inflation factor built into all the other components as well, such as maintenance?

[250] **Mr Percy:** It is built into the charge. The PFI operator will set a unitary charge for the facility, which is inflated each year. So, the total charge is inflated, but you can then analyse a component. In effect, each one is inflated, so the maintenance costs are inflated.

[251] **Alun Cairns:** I do not think that it means that we pay twice, because the comparator is always the same.

[252] **Mr Percy:** Yes.

[253] **Alun Cairns:** Have you finished your broad overview? Finish that first, and then we will deal with the more detailed questions.

[254] **Mr Percy:** A key thing that you need to do is ensure that you are comparing like with like. So, we will come back to the detailed comparison of the numbers. You know your PFI charges, so you can assess those. You need to compare those to something, so that you build up a public sector comparator. Considerable work is done on that. Essentially, you break it down to each component. So, you will look at the build price and the specification, and you test what it would cost to build that under the traditional procurement route. In the hospital example, that was done by going to a recognised public sector body to get data on construction costs for building hospitals.

[255] On the revenue costs in the example given, given that it was procured through the health authority, it looked at its current charges and said, 'If we are to clean to this standard, the cost would be this' or whatever, and it assessed that. It would then look at the maintenance required and work with outside advisers, usually—and in this instance, it was a firm of cost consultants—to estimate what it would cost to carry out that maintenance. So,

that gives you the base data of what it would cost by going down a public sector procurement route.

[256] The other key aspect, in addition to the base-cost data, is the risk for the project and the risks being borne under the contract by the private sector under a PFI model set against the risks under that option in the public sector. Fairly detailed work is done on assessing those risks and then quantifying them so that you can evaluate them. The numbers are extrapolated from the PFI side and from the public sector comparator side, including the risk, and are then inputted into a model. The model and the guidance say that you look at the discounted values for each to assess whether you have value for money. At the back of the paper, we have given a summary assessment of the results for this illustrative example.

[257] **Alun Cairns:** When would this be done? Is it done at the beginning? A Minister wakes up one morning and thinks that he or she wants to build a hospital. Is this comparison done at that stage to decide which route to take, or is it done in principle at the outset and then in a much more detailed way at a later stage, so that it justifies the decision, or is it a genuine, objective assessment? In this hospital example, the PFI model may be beneficial to the taxpayer.

[258] **Mr Percy:** It is done in two phases. The initial assessment is done as an outline business case to demonstrate whether you can proceed, and then, at the end of the procurement process, you do the detailed assessment to get the final approval to sign the contract.

[259] **Alun Cairns:** Before I bring in Alun Ffred, I want to ask whether there have been any examples in which the figures in principle have stacked up in the way that is presented in paper 4, but then, when the detailed analysis and costings are done, a Minister has said, 'Hang on a minute; this has actually reversed, and does not provide the value that it appeared to provide at the in-principle decision stage'.

[260] **Mr Percy:** There will be such examples. I am currently working on a hospital project within the independent sector treatment centre programme in England, which is not strictly a PFI project. It was announced in the press yesterday. Four business cases were submitted for approval. Three were approved, and the approval of one has been held subject to further clarification on the value-for-money assessment of that project. You can see details of that in the press release issued by the Department of Health yesterday.

[261] **Alun Cairns:** That is reassuring.

[262] **Alun Ffred Jones:** I am looking at the summary assessment here. Am I right to say that many of the arguments for and against PFI are centred on this risk transfer? In essence, it is the risk transfer that gives the PFI schemes the edge, in this case. Is that generally true?

[263] **Mr Percy:** It will, essentially, be the risk transfer that will assess it, but you need the risk transfer to make sure that you are comparing like for like because there are certain costs in the risk transfer here that are in-built in the PFI unitary charges. A simple example is that the PFI charges include insurance, whereas it is not in the public sector side, so it is in that risk transfer figure. That is the cost of building insurance. However, it is the risk transfer that is critical to achieving value for money. If you are not passing on the risk, you are not going to achieve it.

12.10 p.m.

[264] **Jenny Randerson:** I wish to move on and take it away from this specific example. Ages ago, I remember you telling us that the Treasury no longer regarded information

technology contracts as suitable. What is the difference, in terms of that analysis, between an IT contract and a building?

[265] **Mr Percy:** The biggest issues on an IT contract are the lifespan of the IT equipment due to technological changes, how you could capture that within the contractual relationships and how you could define your user requirements. How can you know what you will need from an IT point of view in 25 years' time?

[266] **Alun Ffred Jones:** How do you know what you will need even in 10 years' time?

[267] **Mr McCann:** The evidence is much less developed. Jon talked earlier about a project that had gone through the construction phase and, on that, we have quite an impressive bank of information to go on, in terms of what the risks are and where they will lead us. The information is much less developed for IT projects because they are so variable and because they pan out in so many different ways.

[268] **Mr Percy:** Picking up on Jon's point, the question is whether you can really manage that risk. Can you really define that risk? If technology took a leap that you had not anticipated, effectively, you would end up back with the public sector.

[269] **Alun Cairns:** Before I bring Alun Ffred in, may I come back to risk transfer and talk through a simple example? When Mr Williams was here from the Bro Morgannwg NHS Trust, he used the example of a lift breaking down in the Princess of Wales Hospital. It was going to cost him a £2-million capital grant application to the Assembly Government in order to pay to repair it, but if a lift broke down in Baglan Moors, it was not his problem. Let us imagine that a lift breaking down is extremely rare and that they are built to last for 100 years. However, there is obviously a risk that they could break down. Could that be the sort of example that would be charged in the risk transfer? In the private sector comparator, would that be the sort of risk that was being taken account of?

[270] **Mr Percy:** That would be an example of risk. That could be done. Yes, you would protect yourself against that.

[271] **Alun Cairns:** So, if the public sector is building something itself and is going to maintain it and look after it, it needs to accept it and say, 'Well, heck, we are running a risk that the lift could break down and we would need to spend £2 million on repairing it.'.

[272] **Mr Percy:** Exactly. We have tried to summarise the top 10 risks on that project and, if you just flick through—

[273] **Alun Cairns:** There is nothing about lifts. [*Laughter.*]

[274] **Mr Percy:** No, there is nothing about lifts. However, there is something about poor project management leading to claims, delays and cost overruns. Those are some of the biggest risks for you to understand. What are the chances of those happening? Under a PFI contract, if the contractor does not complete the building on time, he does not get paid and there are penalties for him. If his costs exceed his budget, that is his problem. If it is in the public sector, if the costs exceed the budget, the public sector has to pay and if the building is not available on time, there will be costs associated with delivering that service from whatever the alternative is or by using the existing scenario.

[275] On the insurance risks that I talked about, the public sector usually self-insures its buildings, but the private sector would insure the building against flood and fire damage and so on. That is a cost that the PFI operator takes, which is not there, effectively, for the public sector, or it is a case of self-insurance, so there is a cost there that can be quantified. In this

particular example, one of the risks that was transferred was the risk of any changes to building regulations that would mean, for example, that they might have to put in disabled access that was not required at first.

[276] Under the PFI contract, that would be something that the PFI operator would have to do at its own cost, and so on. Under public sector procurement, if there was a change that you needed in five years' time, the public sector would have to do that, and to take your example, Chair, yes, they would have to go to the National Assembly for Wales and ask for a capital grant to do it. That is an example.

[277] There is probably some fairly close defining of what risks they would take. Here, for example, they have included NHS-specific requirements, because it would be deemed a risk that the private sector would not be able to absorb because they could not legislate for what is likely to come there. So that has been retained with the public sector in that instance, but they were fairly happy that they could manage the risk of changes in general building requirements effectively.

[278] **Alun Cairns:** Alun Ffred is first and then Oscar.

[279] **Alun Ffred Jones:** Again on the theme of risk transfer, which I am beginning to understand, the company would factor that in to ensure that they do not lose any money. They have to make a profit and, therefore, you would imagine that they would be building in profit margins right along the line, which you would have thought might end up making the scheme rather more expensive. In one sense, it is difficult to see how a private company can build and maintain it cheaper because they have to borrow money on the market and they have to factor in the profit margin. Where do they make their money? The unions raised some issues, for example the complaints about the cleaning contracts being tight and perhaps insufficient to meet the standard. So where is the gain? You have maintained, presumably—and sorry to put words in your mouth—that the company insists those things are done properly and on time in order to ensure that they maintain profitability. I suppose that the unions would say that what they do is build in a profit margin, that they do not do things properly and that they are not flexible.

[280] **Alun Cairns:** I wish to come in on that, because we received evidence in which the Confederation of British Industry said quite clearly that it is down to the contract—the contract says whatever it says. So, it is not a point about doings thing properly.

[281] **Mr Percy:** One of the important points here, which comes back to risk transfer, is to get the specification and the contract right at the start. If you do not specify what you want correctly, you will not get it. So the initial contractual negotiations and specifications are big issues, and identifying your need is a critical part of this, because, if you get that wrong, it is likely to lead to problems downstream.

[282] **Alun Ffred Jones:** If the suggestion is that the public bodies do not have the expertise to run these contracts properly anyway, and that they are going to be run over by private contractors, presumably they do not have the expertise either to make these contracts properly under PFI schemes?

[283] **Mr Percy:** Where you get value for money is an interesting issue. If you look at these contracts, often, under a PFI arrangement, the build costs at the outset are higher. One reason for that is that they will specify certain things to a higher specification than the public sector would because they pay regard to the future maintenance required. The classic example that is often referred to in a hospital PFI is that the standard of the doors is usually higher than in a public sector hospital because trolleys keep hitting the doors, so better doors are put in to last longer, instead of having to replace a door every year. So you get some efficiency through

that. The private sector would argue that they are better at procuring some of the services and are therefore procuring more efficiently and reducing the costs. We have extracted this analysis from the limited information that was made available to us. I do not have the detailed business case in order to go in to the nitty-gritty of where the differences are and where the value for money came from.

12.20 p.m.

[284] **Alun Cairns:** Have you finished, Alun?

[285] **Alun Ffred Jones:** Yes.

[286] **Alun Cairns:** I need to move on quite quickly, now. Oscar.

[287] **Mohammad Asghar:** Thank you, Mr Percy. I listened to you keenly. My first question is in two parts. First, how many beds will this hospital have? Secondly, professional costs have not been mentioned. Normally, legal costs are between 10 and 20 per cent for advice, but I have not seen anything here.

[288] **Mr Percy:** I will answer straightly—

[289] **Mohammed Asghar:** You just heard this morning—

[290] **Mr Percy:** It is a good question. I do not have the data in front of me as to how many beds the hospital will have.

[291] **Alun Cairns:** That is enough. [*Laughter.*] I am sorry; I thought you meant the cost of lawyers rather than the other point.

[292] **Mohammad Asghar:** That is second.

[293] **Mr Percy:** The analysis given to us for this example did not give the breakdown of the PFI costs. Those costs will include all the professional fees. We were not party to the analysis of how much of that figure is professional fees.

[294] **Alun Cairns:** In the figures that we have, are professional fees included?

[295] **Mr Percy:** Professional fees are included, yes. It is how they allocate their charges, effectively, and how they build up their costs.

[296] **Mohammad Asghar:** It was mentioned earlier that it was between 10 per cent and 20 per cent. That would be an average of £3 million.

[297] **Mr Percy:** The professional costs would be more related to the build costs rather than the total of £440 million, effectively.

[298] **Alun Cairns:** I ask Ann Jones to come in very quickly, and then I want to close the session.

[299] **Ann Jones:** The unions gave us some evidence, but I have some personal experience of dealing with a PFI project in which, when the staff element suddenly changed, the contractor decided that it was not then cost-effective. I do not see in any of this—and I realise that you have tried to do it as a hypothetical example—how staff changes have been accounted for; they must be accounted for. The unions talked about two people, but this was a complete, wholesale change, and, suddenly, the contract was not as attractive to the

contractor. The people who are setting the contracts up do not know where the pitfalls are. How is that built in to a risk factor? Surely it is a risk factor.

[300] **Mr Percy:** As part of the initial evaluation, one of the things that we would do is look at which services will move. If a new hospital is replacing an old hospital, one of the early parts of the whole process would be to identify which services would be provided under the new arrangement and, looking at the new arrangement, which staff would be involved. Simon probably knows more about that part of the TUPE retention of employment issues associated with that. Part of the due diligence exercise undertaken in the public sector and the private sector would involve, particularly from the private sector point of view, understanding what staff are involved and their conditions because, if they are being transferred, they would need to understand the pay and conditions. If they are doing that, that is part of their cost model, because they are responsible for those payments. With the project that I am working on in England at the moment, working out the pool of staff that will be affected by these contracts and the conditions has been a topical issue. In those instances, the private sector operator has been particularly interested in understanding what the pay and conditions of those staff are, because that features in its financial model.

[301] **Ann Jones:** Can I just take you back? From my experience, my problem was that the contract had been drawn up, but neither side understood what they had signed up to—so that was the private contractor and the public side of it. Neither side understood what they had signed up to in relation to staff. I think that the staff issues are more of a risk factor—and that must be built in—but I cannot find anywhere that shows where you build that in. It might be that I am being totally stupid on this—

[302] **Mr Percy:** The risk of the actual cost of the staff and any disputes and so on does transfer to the private sector with the staff themselves, because the nature of TUPE rights is that they follow the individual; they cannot be allocated by contract as such; they follow the individual employee when they move from the public to the private sector and if another company then takes over employment, those same accrued TUPE rights follow that individual again into the new employment.

12.25 p.m.

[303] **Ann Jones:** Except that they do not, do they, if they have a new contract?

[304] **Mr McCann:** Who? The employee?

[305] **Ann Jones:** Yes.

[306] **Mr McCann:** One cannot change the basic terms and conditions of employment other than by collective agreements and so on.

[307] **Ann Jones:** Yes, but where do we factor that into this public sector comparator?

[308] **Mr Percy:** We have outlined the top 10 risks, but one of the risks that we have identified is the increase in facilities management costs. Facilities management would be the porters, cleaners and so on, so it would be the staff and labour within that.

[309] **Ann Jones:** Okay, I have got it now, thank you. Sorry, I was being stupid there.

[310] **Alun Cairns:** I will bring this session to a close, unless there is a pressing issue, because we are out of time. However, the next item should be straightforward.

[311] Thank you both again. That was an excellent session, which enabled us to tease out

the issues and get a better understanding of where we are in each contract. It has answered some questions, but has perhaps raised others.

12.26 p.m.

Y Mesur Gwneud Iawn am Gamweddau'r GIG
NHS Redress Measure

[312] **Alun Cairns:** Everyone has had a copy of the draft report on the NHS Redress Measure. I have one suggestion of a change to paragraph 4, which states:

[313] 'Overall the committee was disappointed that the information to assess the costs of implementing the Measure was weak.'

[314] We need to clarify the fact that at the outset the information was weak, but give full credit to the Minister for recognising that and responding fully.

[315] **Mr Grimes:** That was a quotation from our report, so it was what was concluded at that time.

[316] **Alun Cairns:** So, we could say, that, overall the committee was disappointed that at the outset, the information to assess the costs of implementing the Measure was weak.

[317] Are we all happy with that? In fairness, the Minister recognised that, to her credit. I see that you are happy with that. Thank you, that brings our proceedings to a close.

Daeth y cyfarfod i ben am 12.27 p.m.
The meeting ended at 12.27 p.m.