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Trish Haines
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Dear Ms Haines

Herefordshire and Worcestershire Waste PFI Project – Variation Business Case (VBC)

We spoke on 01/11/2013 and I am following up on the matters we discussed. I thought it might be helpful if I summarised progress before the meeting we have scheduled for Thursday.

As I am sure you are aware WIDP has, in accordance with standard practice, been undertaking a review of the draft Variation Business Case (version 1.0) submitted on 31 July 2013 and subsequently updated in September 2013. This process incorporates a joint review with IUK/HM Treasury on the financing structure proposed by the Councils, as outlined in the VBC.

1. VBC approval process

In April 2011, we wrote to John Hobbs confirming the process in relation to the VBC. The process consists of two stages, a review of the outline VBC followed by a review of the VBC once the commercial terms of the proposed variation have been substantially agreed between the Councils and the Contractor.

The VBC will be subject to a scrutiny process by WIDP, which will include a Commercial Review by WIDP's Commercial Team. The Commercial Review will assess the commercial terms of the proposed variation. We also explained that WIDP's scrutiny of the VBC may affect your continuing entitlement to PFI grant, or the level of that grant.



2. Status of the VBC Review

In relation to your Project, the VBC is based on the Councils' preferred funding structure of 100% public finance. We were made aware of this in April of this year. Having received an unredacted copy of the contract documentation in June and discussed matters with the project team, our initial view was that **REDACTED UNFINISHED INFORMATION**

In July, the VBC was submitted on the basis of the Councils' preferred funding structure. Since then, WIDP and IUK have been working together with your project team to scrutinise the proposed funding structure and the options/VfM analysis (which is still work in progress). To speed up the process, we have also started work on the Commercial Review.

Based on the information that the Councils have provided via the VBC and clarification responses, our findings are as follows:

2.1 REDACTED COMMERCIALY CONFIDENTIAL

WIDP and IUK have gone through several rounds of discussion with the Councils on the proposed structure. We provided some feedback on this proposal to the project team during the discussion and also in writing, **REDACTED COMMERCIALY CONFIDENTIAL**.

REDACTED COMMERCIALY CONFIDENTIAL It would be useful to reiterate that when the PFI Credit was allocated in 1998, as per the applicable guidance at the time, the aim was to assist local authorities to gain the benefit of new capital investment by bringing in private sector finance and operational management on a risk-taking basis.

REDACTED COMMERCIALY CONFIDENTIAL In this regard, the test is whether we have strong evidence that the private sector is bearing most of the risk as measured through the risk reward test as per HMT's "Technical Guidance on the Application of the Standards used in the production of National Accounts to PFI and Similar Transactions - 2009" ("HMT Technical Guidance").

2.2 REDACTED COMMERCIALY CONFIDENTIAL

Both WIDP and IUK had several discussions with the project team on this issue. **REDACTED COMMERCIALY CONFIDENTIAL**. Clearly the option analysis that we reviewed was still work in progress. We look forward to receiving the completed value for money analysis in due course, amended to take account of the changes as a consequence of our comments and your continuing development work.

2.3 Commercial Review

Based on the Commercial Issue template e-mailed by the project team on 18/10/2013, there are some key commercial issues for which the agreed positions are not yet clear. Some of the comments (e-mailed to the project team on 24/10/2013) are outlined below:

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3. Other options currently explored by the Councils

3.1 REDACTED COMMERCIALY CONFIDENTIAL

3.2 Other possibilities

As outlined in **REDACTED WCC OFFICER** e-mail dated 1 November 2013, we understand that you are exploring whether other possibilities might exist, recognising you are unable to make any specific proposals at this stage. **REDACTED UNFINISHED INFORMATION**

We recognise that since September 2013, the Councils' project team has worked hard to explore the options available to it. We hope that this letter will help the Councils to progress consideration of which option is best for the Councils and we will continue to provide the Councils with the necessary assistance in reaching a view on this.

We will be happy to discuss these matters further on Thursday.

Yours sincerely



Nigel Atkinson

Programme Director

Waste Infrastructure Delivery Programme (WIDP)

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Cc Alistair Neill, Chief Executive, Herefordshire County Council

Cc **REDACTED** Worcestershire County Council

Cc WIDP programme office

Cc Jo Fox – HMT

Cc **REDACTED** – HMT



Annex 1 – Comments on the Option Analysis

(As per REDACTED HMT OFFICER e-mail on 30/10/2013)

WIDP and IUK comments on the option analysis

24/10/2013

1. Background

The Councils have done an option analysis on the technology choice as part of the adoption of the Joint Municipal Waste Management Strategy (JMWMS - August 2011). The JMWMS identified Energy from Waste (EfW) as the preferred technology in a report entitled Residual Waste Options Appraisal. The Residual Options Appraisal was refreshed in November 2012 to review whether the options around preferred technology had changed. The report identified EfW continues to be the preferred technology solution. The Variation Business Case (VBC) focuses on the options available to the Councils within the context of the adopted strategy.

At this stage, the VBC option analysis is still being refined by the Councils incorporating different funding options for the EfW variation option. Because some of the funding options might not be viable and some are still being developed, at this stage our comments only cover the approach on following options:

- **REDACTED COMMERCIALY CONFIDENTIAL AND UNFINISHED INFORMATION**

The comments are based on the information provided in the draft VBC (e-mailed on 08/09/13) and the note from the Councils' Risk Workshop (e-mailed on 17/10/13).

2. **REDACTED COMMERCIALY CONFIDENTIAL AND UNFINISHED INFORMATION**

REDACTED COMMERCIALY CONFIDENTIAL AND UNFINISHED INFORMATION

3. **REDACTED COMMERCIALY CONFIDENTIAL AND UNFINISHED INFORMATION**

REDACTED COMMERCIALY CONFIDENTIAL AND UNFINISHED INFORMATION

4. Optimism Bias: **REDACTED COMMERCIALY CONFIDENTIAL AND UNFINISHED INFORMATION**

REDACTED COMMERCIALY CONFIDENTIAL AND UNFINISHED INFORMATION

a. **REDACTED COMMERCIALY CONFIDENTIAL AND UNFINISHED INFORMATION**

The Green Book recommends that adjustments made to the estimates of projects costs should be based on data from past or similar projects, and adjusted for the unique characteristics of the project in hand. **REDACTED COMMERCIALY CONFIDENTIAL AND UNFINISHED INFORMATION**

b. **REDACTED COMMERCIALY CONFIDENTIAL AND UNFINISHED INFORMATION**

The generic categories in the Supplementary Green Book Guidance have been prepared from the results of a study by Mott MacDonald into the size and causes of



cost and time overruns in past projects (2002). The use of the upper bound figures from the table in the Green Book requires an informed consideration whether the contributory factors to the risk/uncertainty can be mitigated to reduce the optimism bias.

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5. **REDACTED COMMERCIALY CONFIDENTIAL AND UNFINISHED INFORMATION**
6. **REDACTED COMMERCIALY CONFIDENTIAL AND UNFINISHED INFORMATION**
7. **REDACTED COMMERCIALY CONFIDENTIAL AND UNFINISHED INFORMATION**

