



House of Commons
Committee of Public Accounts

The Department for Environment, Food and Rural Affairs: oversight of three PFI waste projects

Fourteenth Report of Session 2014–15

*Report, together with the formal minutes
relating to the report*

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Committee of Public Accounts

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Summary

The Department for Environment, Food and Rural Affairs (the Department) is responsible for ensuring that the national portfolio of projects is sufficient to reduce the amount of waste sent to landfill to meet the EU target. The Department provides grants to some local authorities using the Private Finance Initiative (PFI) to build new waste management infrastructure. However the Department does not accept responsibility for projects delivered by local authorities to meet the national targets for which the Department is responsible. PFI contracts typically last for 25-30 years and this does not offer the necessary flexibility to respond to rapidly changing technology and changing policy requirements for waste disposal. Furthermore, the Department has been unacceptably slow to intervene in projects that are struggling to deliver the required waste management infrastructure leading to delays and incurring extra costs. The Department's handling of the Norfolk PFI waste project has been particularly poor with the Department failing to exercise good judgement by agreeing to give funding to the project and then failing to give sufficient consideration to the local impact of its decision to withdraw funding to that project. This contributed to the contract being cancelled which has left Norfolk taxpayers facing a bill of some £33.7 million.

Conclusions and Recommendations

1. In 1999, the European Union introduced a Directive requiring all member states to reduce the amount of biodegradable municipal waste sent to landfill. The Department has responsibility for ensuring that England diverts sufficient waste from landfill to enable the UK to meet its target under this Directive of sending less than 10.2 million tonnes of waste to landfill a year by 2020. Local authorities have statutory responsibility for disposing of their municipal waste. The Department established a programme in 2006 to encourage the development of local authority waste infrastructure by providing support, guidance and funding to local authorities undertaking waste projects through PFI contracts. The Department part-funds local PFI projects through this programme. Local authorities are the signatories to the PFI contracts and are responsible for ensuring that their waste contracts represent value for money. The Department contracts staff from an organisation, Local Partnerships, to provide the technical support to local authorities. The Department, which oversees the allocation of funds and scrutinises local authorities' plans, has allocated £1.7 billion of PFI credits to 28 local authorities under the programme. Our inquiry focused on the Department's support to three PFI waste projects run by Norfolk County Council, Surrey County Council and a joint project managed by Herefordshire Council and Worcestershire County Council.

2. **The Department's support of PFI to build waste management infrastructure may result in long term contracts that are too inflexible for a sector where technology is continually evolving and the amount of waste produced can be hard to predict.** The Department's approach incentivises the use of PFI to construct waste management assets over other options for reducing the amount of waste sent to landfill. While the Department has told local authorities that there are alternatives to PFI contracts for constructing waste management infrastructure, such as selling the waste, it has more work to do to improve local authorities' contracting capability, especially for PFI projects. PFI contracts typically last 25-30 years and may be inappropriate for the waste sector where technology is continually evolving and the amount of waste that will be produced in the future can be hard to predict. For example, the Department conceded that future waste infrastructure will need to generate both electricity and heat to be environmentally sensible, rather than just generating electricity as some older plants do. Moreover, domestic recycling rates are higher now than was predicted when some of the older projects were approved.

Recommendation: *The Department should consider including other forms of support to help local authorities to manage their waste in ways that are flexible enough to deal with changes in technology and waste levels to ensure local authorities are not locked into projects that provide more capacity than is required and are very expensive.*

3. **The funding agreements for the early PFI waste deals were poorly drafted and too lax as they require payments to be made even though some of the key assets planned have not been built.** The Department's predecessor, the Department for Environment, Transport and the Regions, signed funding agreements with Surrey

and with Herefordshire and Worcestershire councils for waste projects in 1998 and 1999. Under these agreements, central government started paying grants to the local authorities as soon as the contractors began to deliver waste management services rather than waste management assets. The supporting PFI contracts signed by the local authorities did not require all of the expected assets to be constructed, resulting in the Department having paid £213.5 million in grants to the councils over the last 15 years even though the main waste assets have not yet been built. The Department maintains that later funding agreements are more robust.

Recommendation: *The Department has more work to do to improve local authorities' contracting capability, especially for PFI projects. It needs to be much clearer about the outputs and outcomes it requires when funding future waste projects and ensure that it only pays for what is delivered.*

4. **The Department waited far too long before renegotiating its funding agreements with Surrey and with Herefordshire and Worcestershire Councils.** Since taking over responsibility for overseeing these PFI grants in 2001, the Department continued to allow payments to be made to Surrey and to Herefordshire and Worcestershire councils even though key infrastructure had not been built. The Department only altered its funding agreements with these councils in 2013 when the Department negotiated a £30 million reduction in its payments to Herefordshire and Worcestershire Councils, and a change in the timing of its payments to Surrey County Council.

Recommendation: *The Department should act with far greater urgency when it has concerns about a project's progress.*

5. **The Department supported the Norfolk scheme despite having strong reservations about the local authority's timetable for securing planning permission. This contributed to the £33.7 million bill Norfolk taxpayers now face.** The Department had serious concerns as far back as 2010 over Norfolk County Council's timetable for obtaining planning permission for its proposed energy-from-waste facility. Although the Department warned the council that its timetable was too ambitious, the Department still agreed in February 2012 to provide £91 million of PFI credits to part-fund the Norfolk project. We do not accept the Department's assertion that because the Norfolk PFI contract met its funding criteria, it was a reasonable decision for the Department to agree to part-fund the project. If the Department had not promised funding support in early 2012 it might have prevented the Council from signing the contract. By later withdrawing support the Department contributed to the decision to subsequently terminate the contract, which has left local taxpayers facing an estimated £33.7 million bill for compensation to the contractor.

Recommendation: *The Department should not agree to fund schemes until all its concerns have been resolved.*

6. **Local authorities need better advice on negotiating PFI contracts, particularly on technical aspects such as when to secure finance, and compensation arrangements.** PFI contracts are complex and require specialist knowledge to

achieve value for money. Local authorities, who are likely to enter into such contracts only once in a generation, lack the significant expertise that resides in central government. The Department and the Treasury provide local authorities with guidance and point them towards specialist external advisors, but they do not provide direct advice. This has resulted in some councils making poor decisions and wasting taxpayers' money as exemplified by the cancellation of Norfolk's PFI contract where the council decided to put the finance for the facility in place before planning permission had been received, resulting in it having to pay more compensation to the contractor when the contract was terminated. Similarly the terms of the contract signed by both Surrey County Council and Hereford and Worcestershire Councils obliged the councils and the Government to pay contractors for services without a capital asset, which the Councils intend should be built, being provided.

Recommendation: *The Department should make better use of its position and expertise to support local authorities in negotiating PFI contracts and achieve value for money for local taxpayers.*

7. **The Department has made decisions on this programme focused entirely on the need to meet the EU target without due regard to the impact of its decisions on local authorities.** The Department agreed to provide funding support to the Norfolk project in February 2012 but withdrew its funding in October 2013 because it judged that the Norfolk plant was no longer needed to meet the 2020 EU landfill target. The Department's decision to withdraw funding was a contributing factor to the Council's decision to cancel the contract the following year, at an estimated cost to Norfolk taxpayers of £33.7 million. The Department was fully aware of the likely compensation costs that would be incurred when it decided to withdraw funding.

Recommendation: *The Department needs to balance the need to meet the EU target at minimum cost, with making sure that its decisions serve taxpayers' interests as a whole and do not result in additional costs for local authorities. The Department should place more weight in its decision-making on the cost to the public in the round when it considers withdrawing its support to individual projects.*

1 The Department's waste infrastructure programme

1. On the basis of a Report by the Comptroller and Auditor General, we took evidence from the Department for the Environment, Food and Rural Affairs (the Department) on its oversight of three PFI waste projects run by Norfolk County Council, Surrey County Council and a joint project managed by Herefordshire Council and Worcestershire County Council.¹

2. In 1999, the European Union introduced a Directive requiring all member states to reduce the amount of biodegradable municipal waste sent to landfill. The Department has overall responsibility for ensuring that England diverts sufficient waste from landfill to enable the UK to meet its target under this Directive of sending less than 10.2 million tonnes of waste to landfill a year by 2020.²

3. The Department established the Waste Infrastructure Delivery Programme (the programme) in July 2006 to help it meet England's contribution towards the EU 2020 target. The aim of the programme is to encourage and support local authorities to develop new waste infrastructure by providing support, guidance and funding. Through the programme, the Department allocates funding for some local authority PFI projects and scrutinises local authorities' plans. The Department also provides funding to a number of PFI projects that pre-date the programme, reaching as far back as 1997-98.³ Local authorities are the signatories to the PFI contracts and are responsible for ensuring that their waste contracts represent value for money.⁴ The programme only provides funding support for local authorities that are entering into PFI contracts to construct waste management assets. This incentivises councils to use PFI over other options for diverting waste from landfill. PFI contracts are long-term undertakings, typically running for 25 to 30 years. The Department is currently providing PFI credits for a range of waste management projects, which include integrated recycling facilities as well as energy-from-waste incinerators.⁵

4. When deciding whether to fund these PFI projects, the Department had to forecast the amount of waste that would be produced. The Department told us that future levels of waste are difficult to predict. Notably, recycling rates are higher now than was predicted when some of the older projects were approved and there are new technologies available for disposing of waste.⁶ There are also opportunities to sell waste to European countries where energy-from-waste plants have been built to provide municipal heat and power, and there is a substantial demand for waste to burn.⁷ The Department noted that it had

1 [C&AG's Report, Oversight of three PFI waste projects, Session 2014-15, HC 264, 17 June 2014.](#)

2 [C&AG's Report, Oversight of three PFI waste projects, Session 2014-15, HC 264, 17 June 2014, Appendix Four, para 1 to 4.](#)

3 [Q 2](#)

4 [C&AG's Report, Oversight of three PFI waste projects, Session 2014-15, HC 264, 17 June 2014, paragraphs 1.1 to 1.7.](#)

5 [Q 13](#)

6 [Qq 6, 29](#)

7 [Qq 31, 33, 119](#)

highlighted to local authorities that selling waste is an option, but it had not incentivized this approach.⁸

5. The Department told us that despite higher recycling rates and new waste-management technologies, it still thought that it was right to provide long-term funding for waste incineration plants. The Department argued that the provision of long-term funding for infrastructure projects from the 1990s onwards was essential as ‘in order to get a marketplace to deliver these things, we had to give a degree of certainty’.⁹ The Department also told us that the incinerators that it had been funding were still needed to meet the EU targets for 2020 and form part of a package of different types of facility to reduce the use of landfill. The Department conceded, however, that new waste infrastructure needs to generate both electricity and heat to be environmentally viable and stated that it had no plans to provide PFI credits for any new incinerator schemes.¹⁰

6. Early PFI waste contracts tended to be for integrated waste management contracts, under which contractors provide a range of waste services. By contrast, more recent PFI waste management contracts provide for the construction of specific infrastructure. The early funding agreements for PFI waste management projects that the Department inherited from its predecessor, the Department for the Environment, Transport and the Regions, differ from those signed more recently. The early funding agreements under which the Department for the Environment, Transport and the Regions had agreed to provide funding to local authorities had looser terms which typically committed the Department to start paying grants to the local authorities as soon as the latter began to make payments to the contractors under the contracts. The payments were based on services delivered rather than infrastructure built and the agreements contained no provision for the Department to halt or modify payments without the agreement of the local authority when individual capital assets were not delivered.¹¹

7. The funding agreements signed with Surrey County Council and with Herefordshire and Worcestershire Councils highlight the shortcomings of these early agreements to fund PFI projects. In both cases, the Department’s payments to the local authorities were aligned with the payments being made by the local authorities to the contractors. The grant payments therefore began as soon as the local authorities began to pay their contractors and the Department has been legally committed to making grant payments to these councils ever since, even though key assets have still not been built.¹² This occurred because the underlying PFI contracts, which dictated the payments owed by the local authorities to the contractors, related to a range of services and committed the local authorities to pay the contractor provided that it achieved certain targets in recycling and waste recovery and did not require all of the expected assets to be constructed before payments started.¹³

8 [Qa 31,119-121](#)

9 [Q 33](#)

10 [Qa 6,16](#)

11 [C&AG's Report, Oversight of three PFI waste projects, paragraphs 2.21 to 2.26](#)

12 [Qa 21, 23](#)

13 [Q 22](#)

8. The Department and its predecessor began making payments to Surrey County Council in 1999 and, by the end of March 2014, had paid £124 million under this funding agreement. The contract that Surrey signed had originally provided for the construction of two energy-from-waste plants, but these have yet to be built.¹⁴ Payments to Herefordshire and Worcestershire County Councils began in December 1998 and totalled £89.5 million by 31 March 2014. Again, the planned energy-from-waste plant has not been built.¹⁵

9. The Department told us that “[we] have changed the way that we do these contracts, so there are much tighter conditions on the local authority about what happens to the money and what triggers penalties or payments”.¹⁶

10. PFI contracts are complex and specialised instruments that require skilled handling to achieve value for money. Individual local authorities are only likely to enter into such contracts once in a generation. However, there is greater experience and expertise in handling them within central government such as in the Department and HM Treasury. The Department has provided support to local authorities since the start of the programme to help them handle complex PFI projects. In addition to providing local authorities with guidance on planning issues, technology, and procurement options, the Department has funded Partnerships UK to act as ‘transactors’ to provide expert support and advice to councils. The Department also told us that, when dealing with specialist areas such as hedging, it pointed authorities to external organisations who could provide support.¹⁷ Norfolk County Council in their evidence said that the Department examined and vetted all details of the proposed contracts.¹⁸

2 The Department’s oversight of three PFI waste projects

11. The Department for the Environment, Transport and the Regions signed a funding agreement with Surrey County Council in June 1999 for £204.7 million of PFI grant and with Herefordshire Council and Worcestershire County Councils in December 1998 for £143 million.¹⁹ Payment of these grants to the local authorities began shortly after. The terms of the original funding agreements did not allow central government to unilaterally halt or alter the payment terms in the event that key capital assets were not delivered.²⁰ Although the Department has had responsibility for overseeing these grants since it was created in 2001, it did not review these agreements until 2011, and did not successfully renegotiate the terms with Surrey and with Herefordshire and Worcestershire councils

14 [C&AG’s Report, Oversight of three PFI waste projects, paragraphs 1.10 to 1.13](#)

15 [C&AG’s Report, Oversight of three PFI waste projects, paragraphs 1.14 to 1.17](#)

16 [Q 111](#)

17 [Qq 62-6](#)

18 [Written evidence from Norfolk County Council to the PAC, 23 June 2014, p 1](#)

19 [C&AG’s Report, Oversight of three PFI waste projects, paragraphs 1.10 and 1.14](#)

20 [Q 22](#)

until 2013.²¹ As a result, grant payments of £213.5 million were made over fifteen years to Surrey and to Herefordshire and Worcestershire councils even though key facilities were not built. The process of renegotiation was time-consuming. In the case of the Herefordshire and Worcestershire negotiations, Defra confirmed that it took them six months to approve the new funding approach that the local authorities were proposing.²²

12. The renegotiations with Surrey did not alter the total amount of funding that the Department will provide, but 're-profiled' the schedule of payments. Surrey is expecting a new waste management facility, including a gasifier to produce fuel from waste, to be operational by 2016-17. Under the renegotiated terms, the Department's payments to Surrey has been reduced for the three years beginning 2013-14 and will continue to be lower until the gasifier starts processing waste.²³

13. The Department's negotiations with Herefordshire and Worcestershire concluded with it reducing the total funding it will provide by £30 million. The planned energy-from-waste plant experienced serious delays in getting planning permission and, by the time permission had been obtained, the contractor could not arrange the necessary financing. The local authorities ultimately decided to build and finance the plant outside the PFI contract, without the PFI credits provided by the Department for a lesser sum, with risks being transferred back to the public sector.²⁴

14. The Department signed a funding agreement with Norfolk County Council in February 2012 to contribute £91 million of PFI credits towards a 25-year contract to build an energy-from-waste facility. Norfolk County Council estimate that this would have equated to £169 million in grant payments. However, the planning application to build this facility near King's Lynn was called in by the Secretary of State for Communities and Local Government, and as a result the Council missed the deadline in its funding agreement with the Department to obtain planning permission by 10 June 2013. The Department subsequently revoked its funding in October 2013 and, after initially deciding to proceed without central government funding, Norfolk County Council terminated the PFI contract in April 2014. The contract Norfolk County Council had signed with its contractor included compensation clauses relating to securing finance and foreign exchange hedging and the decision to cancel the contract means that Norfolk County Council is expected to pay the contractor an estimated £33.7 million.²⁵ The bulk of this compensation relates to contractor costs (£20.3 million) which include fees paid for arranging finance, and fees for unwinding hedging arrangements that were intended to mitigate against foreign exchange risk (£11.8 million).²⁶

15. The Department told us that such compensation clauses are standard in the PFI contracts in the programme. Of the eleven bank-funded projects in the programme, the nine that did not have planning consent before financial close all had compensation clauses

21 [Qa 124-7](#)

22 [Qa 113-17](#)

23 [C&AG's Report, Oversight of three PFI waste projects, paragraph 1.13](#)

24 [Q 19](#) and [C&AG's Report, Oversight of three PFI waste projects, paragraphs 1.16-19](#)

25 [C&AG's Report, Oversight of three PFI waste projects, paragraph 1.20](#)

26 [C&AG's Report, Oversight of three PFI waste projects, paragraph 2.41](#)

covering the same sort of costs as the Norfolk contract. Those funded by contractors' balance sheets also contained similar compensation clauses, but without elements related to arranging bank finance.²⁷ So far, the Norfolk contract is the only one where the compensation clauses have been triggered as no other contracts have been cancelled after signature.²⁸

16. The Department told us that, when signing the funding agreement in 2012, it had had serious concerns that Norfolk had not scheduled sufficient time to obtain planning permission. The Department was also aware that any delay in obtaining planning permission posed a serious financial risk to the local taxpayer, as Norfolk had secured finance in advance and signed a related compensation clause with the contractor. The Department raised these concerns with Norfolk County Council as far back as 2010, but the local authority was confident that it would achieve planning permission within the proposed timetable.²⁹ When asked why it had agreed to provide funding despite having such serious misgivings about the project timetable, the Department confirmed that it had been under no legal obligation to provide funding, but had chosen to do so on the basis that it had been a "reasonable decision" given that Norfolk met the Department's criteria for funding and the local authority could have taken the Department to judicial review if it had not provided funding.³⁰

17. A major factor behind the Department's decision to cancel the PFI funding agreement in October 2013 was that the proposed waste facility in Norfolk was no longer needed to meet England's contribution to the EU target.³¹ The decision to cancel the funding agreement came only 20 months after it had been signed and was unprecedented within the programme.³²

18. The Department told us that when it made the decision to withdraw PFI credits from the project, it had been fully aware of the compensation clauses in Norfolk County Council's contract and the compensation costs the council would face if it cancelled the contract. The Department noted that it had considered the impact of withdrawing funding on the affordability of the project to Norfolk when making its decision.³³ Norfolk County Council told us that the Department's withdrawal of funding 'left the County Council limited opportunity to pursue the substantial savings that could have been gained had it adopted different contract terms to those in standard PFI contracts'.³⁴

27 [Written evidence from Defra](#)

28 [Q 37](#)

29 [Qq 34, 58](#)

30 [Qq 43-51](#)

31 [Q 101](#)

32 [Qq 86-90](#)

33 [Qq 39, 85](#)

34 [Written evidence from Norfolk County Council to the Public Accounts Committee, 23 June 2014, p.2](#)

Formal Minutes

Wednesday 3 September 2014

Members present:

Mrs Margaret Hodge, in the Chair

Mr Richard Bacon
David Burrowes
Jackie Doyle-Price

Mr Stewart Jackson
Austin Mitchell
John Pugh

Draft Report (Department for Environment, Food and Rural Affairs: oversight of three PFI waste projects), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 18 read and agreed to.

Conclusions and recommendations agreed to.

Summary agreed to.

Resolved, That the Report be the Fourteenth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Monday 8 September at 3.00 pm]

Witnesses

Wednesday 25 June 2014

Page

Bronwyn Hill CBE, Permanent Secretary, Department for Environment, Food and Rural Affairs; and **Dr Colin Church**, Director, Resource, Atmosphere and Sustainability, Defra, and Senior Responsible Owner for the Waste Infrastructure Delivery Programme

[Q1-138](#)

Published written evidence

The following written evidence was received and can be viewed on the Committee's inquiry web page at www.parliament.uk/pac. DEF numbers are generated by the evidence processing system and so may not be complete.

- 1 Department For Environment, Food And Rural Affairs ([DEF0002](#))
- 2 Norfolk County Council ([DEF0001](#))

List of Reports from the Committee during the current Parliament

The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

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| Second Report | Help to Buy equity loans | HC 281 |
| Third Report | Tax reliefs | HC 282 |
| Fourth Report | Monitor: regulating NHS Foundation Trusts | HC 407 |
| Fifth Report | Infrastructure investment: impact on consumer bills | HC 406 |
| Sixth Report | Adult social care in England | HC 518 |
| Seventh Report | Managing debt owed to central government | HC 555 |
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