

A92 Upgrading – Dundee to Arbroath Design, Build, Finance and Operate (DBFO) Contract

Key Terms Summary

1. Introduction

- 1.1 The purpose of this paper is to provide as far as possible, a plain English summary of the key terms of the A92 DBFO Contract to act as a guide to the level of service required of the PFI Company under the Contract. Whilst every care has been taken to ensure its accuracy, it is not intended to be comprehensive and should not be relied upon as a definitive statement of the contractual position.
- 1.2 The DBFO Contract requires the PFI Company (see below) to provide works and services to Angus Council for the upgrading of the A92 between Claypotts, Dundee and Elliot, Arbroath with ancillary side roads improvements. This works and services are for the design and construction of these new roads and then for the operation and maintenance of the new dual carriageway for 30 years after effective completion and opening of the new roads.
- 1.3 In return for these works and services, the Council will pay the PFI company a service (or “unitary”) charge from the date of effective completion and opening of the new roads which the PFI Company will apply to repay the finance it obtained and to provide a return for its investment.
- 1.4 The scheme proceeded under the government’s Private Finance Initiative (PFI) in terms of which the Scottish Executive will provide Angus Council with fixed revenue support funding of £3.4m per annum towards the unitary charge payment.

2. Contractual Structure

- 2.1 The DBFO Contract is between Angus Council and the PFI Company, Claymore Roads Limited (Claymore), a special purpose limited company set up as the contracting company under the DBFO Contract by the preferred bidder consortium, Morgan Barclays to provide the limited recourse finance structure required under conventional PFI contracting.
- 2.2 The Contract has been negotiated between the Council and Claymore including significant input from the joint funders, AXA Investments Limited and DEPFA Bank plc. This is usual in PFI transactions where the financing structure and the bidders’ proposed solutions to the Council’s requirements are not specified by the Council in advance.
- 2.3 The DBFO Contract comprises a “front end” of the agreement with the more technical details contained in Schedules to the main agreement as follows:
- The Project Agreement (which encapsulates the main terms of the contract)
 - Schedule 1- Definitions
 - Schedule 2 - New Works Requirements (i.e. the Council’s construction requirements)
 - Schedule 3 - Conceptual Design (i.e. Claymore’s design solution to the Council’s New Works Requirements)
 - Schedule 4 - O&M Requirements (i.e. the Council’s requirements for the operation and maintenance of the dual carriageway)
 - Schedule 5 – Conceptual O&M Proposal (i.e. Claymore’s solution to the Council’s O&M Requirements)
 - Schedule 6 – Quality/Best Value (statements of the Council’s requirements and Claymore’s solutions to those requirements)

- Schedule 7 – Payment Mechanism (providing the detail of how the unitary charge payments are to be calculated)
- Schedule 8 – Dispute Resolution Procedure (provides a “fast track” system for resolving disputes between the Council and Claymore akin to construction contract adjudication)
- Schedule 9 – Land, Statutory Orders and Environmental Statement (listing and incorporating by reference the planning permissions, etc. with which the Company must comply in constructing the new roads)
- Schedule 10 – Insurance (states the Council’s insurance requirements of Claymore)
- Schedule 11 - Termination Compensation (where compensation is payable to Claymore on termination of the DBFO Contract – see below – this Schedule states how that compensation is to be calculated)
- Schedule 12 – not used
- Schedule 13 – Project Documents (lists the other documents central to the overall contractual structure and which cannot be changed without the Council’s consent)
- Schedule 14 – Angus Council Representative Powers (states the limits of the powers of the “Angus Council Representative” – see below – under the contract)
- Schedule 15 – Review Procedure (sets out this procedure which applies to certain documents to be produced by Claymore in accordance with Schedule 2)

2.4 In addition to the DBFO Contract, Angus Council has also entered into direct agreements with Claymore’s Funders, construction contractors, maintenance contractors and design etc consultants. These are to provide the Council with additional protection in the event of Claymore’s insolvency and, in the case of the Funders Direct Agreement, to provide the funders with proper security over the unitary charge payments (not the assets) to protect repayment of their financing payments.

2.5 In the following key terms summary, references to Part/Clause/Schedule numbers refer to the Project Agreement. Cross references have been provided throughout for ease of further reference.

3. Parties, Duration (Part 1)

3.1 As stated above, the sole parties are Angus Council (AC) as roads authority and Claymore Roads Limited (the PFI company). AC and Dundee City Council (DCC) have entered into a “Section 56” Agreement (Local Government (Scotland) Act 1973) authorising AC to enter into the Project Agreement (PA) for that part of the A92 being constructed, operated and maintained in Dundee.

3.2 The PA took effect when it was signed on 30 September 2003 and terminates on the earliest of either:

- 30 years after the Scheduled Permit to Use Date (which is 39 months after the PA was signed) i.e. 31 December 2036; or
- 30 years after the Permit to Use (PTU) Date (when the “New Works” (see below) are substantially complete and the roads are safe for opening to traffic); or
- earlier termination on breach as provided for in the Agreement.

See Clause 2.

4. The Operations (Part 2)

- 4.1 From the Restricted Service Commencement Date (RSC) of 8 September 2003 (back-dated to reflect an “advance works agreement” entered into for that purpose between AC and the construction contractor, Morgan Est plc) the PFI Company will be responsible for looking after the existing A92 and side roads to a minimum degree (effectively, keeping the roads safe only) with AC/DCC retaining responsibility for emergency response and winter maintenance. See Clauses 17 and 19.
- 4.2 The PFI Company is responsible for designing and constructing the New Works in accordance with the New Works Requirements (Schedule 2). The construction and maintenance works together are known as the “Operations”.
- 4.3 The PFI Company will not receive any Unitary Charge (UC) payment until PTU is achieved. If PTU is not achieved by the Scheduled PTU Date (31 December 2006), the 30 year concession period starts running anyway (so the PFI Company loses UC revenue for so long as it continues to fail to achieve PTU after that date). The PFI Company only receives 90% UC from PTU until it achieves New Works Final Completion (NWFC) which occurs when the construction works are fully complete, with the exception of unfinished landscaping work to a maximum value of £100,000 in respect of which AC may retain sums from the UC to the value of the unfinished landscaping work. NWFC must be achieved by a latest date of 51 months after the PA was signed, namely 31 December 2007. AC’s remedy thereafter is “step-in” (i.e. taking the place of the PFI Company temporarily) and recovery of costs along with Performance Deductions under the Payment Mechanism. See Clauses 23-26 and 27.
- 4.4 The PFI Company will, however, be given relief for delays outwith its control in certain prescribed circumstances considered to be normal for roads construction (e.g. war, strikes, protester action, AC breach) which may then extend these deadlines. See Clause 25.
- 4.5 After PTU is achieved, the PFI Company will be responsible for carrying out the O&M Services and Works on the Project Roads (i.e. the new dualled A92 but not the newly constructed/improved side roads which will revert to AC) in accordance with the O&M Requirements. See Schedule 4. The PFI Company is also responsible for remedying defects to the accommodation works (works on adjacent owners’ land to mitigate the effects of the scheme) for 12 months after NWFC and for the new side roads for 36 months after NWFC. AC has retained the emergency response function throughout the concession period (as has DCC). See Clause 17.
- 4.6 If AC breaches any of its obligations under the Agreement, this is a Compensation Event and the PFI Company will be kept free of all losses as a result as a result of AC’s breach. This protection is also extended to breaches by DCC in certain events. These circumstances are within the control of AC given the terms of the Section 56 Agreement. See Clause 27.
- 4.7 Whilst the management of protesters and trespassers is a PFI Company responsibility, if the PFI Company is not legally able to remove protesters and trespassers, AC will (either directly or through DCC) use its legal remedies as far as it can subject to the PFI Company meeting all costs of so doing. See Clause 27A.

- 4.8 Schedule 2 requires the PFI Company, on the natural expiry of the DBFO Contract in year 30, to “hand back” the A92 roads with, broadly, at least 5 years’ life left in the road pavement and 90 years’ life left in structures (e.g. bridges, culverts). In security of this obligation, from year 27, AC will be able to deduct from monthly UC payments a sum sufficient to cover the cost of any works to achieve that handback condition (the “Renewal Amount”) which is calculated after inspection and agreement on a renewal programme, spread over the remaining number of monthly UC payments. The Renewal Amount is recalculated quarterly according to any further renewal works done by the PFI company since the last recalculation. The PFI Company has the option of providing a performance bond or other suitable guarantee instead of this retention mechanism, dependent on the bond market at that time. See Clause 29.

5. Access Rights and Statutory Orders (Part 3)

- 5.1 AC is obliged to provide the PFI Company with the rights to occupancy of (a) the New Works Site (i.e. the land acquired and made available by AC and DCC through the compulsory purchase orders etc. for the scheme) from the RSCD until NWFC and (b) the O&M Site (i.e. the New Works Site less the new side roads) from when the O&M Services start to be provided. See Clauses 30 and 31.
- 5.2 The right for the PFI Company to occupy the New Works Site/O&M Site is not exclusive and AC e.g. expressly retains the right to access during the New Works phase for its retained emergency response during the full contract period and winter maintenance services during the Restricted Services Period. See Clause 32A.
- 5.3 However, if AC takes or gives access other than for the purposes of the DBFO Contract or undisclosed/unknown third party rights exist such as prejudice performance of the Operations, the PFI Company will be compensated by a deemed Compensation Event. Further, if those other access rights frustrate performance of the Operations for more than a defined period (to be agreed), the PA will terminate and the PFI Company will be entitled to receive full AC termination compensation. See Clause 33.
- 5.4 AC warrants the validity of the Access Rights and Statutory Orders. If they are quashed on Judicial Review or other court challenge then AC has the option to either: (i) instruct a change varying the Operations accordingly; or (ii) terminate the PA as a result of which the PFI company is entitled to receive full AC termination compensation.
- 5.5 The PFI Company is, however, responsible for verifying the sufficiency of the Access Rights and Statutory Orders, to allow carrying out of the Operations (e.g. that the PFI Company’s conceptual design will fit into the New Works Site). See Clause 34.
- 5.6 Where the exercise of statutory powers by AC, DCC or other relevant statutory authority is required for the Operations and such exercise is refused, this will be a deemed AC Change to the O&M Requirements only to the extent required to allow performance of the PFI Company’s obligations under the PA. See Clause 35.

6. Changes (Part 4)

- 6.1 The basic mechanism for AC Changes to the New Works Requirements, Conceptual Design or O&M Requirements is that AC can issue a Change Notice requiring the PFI Company to provide a fixed or tendered price for the Change. The Company will then respond with a Change Appraisal including the fixed/tendered price and an estimate of the costs/savings and other contractual consequences arising from the Change, if implemented. The PFI Company is obliged to deliver a Change Appraisal unless the proposed AC Change would fall within prescribed veto situations (e.g. technically unfeasible, illegal or contrary to good industry practice). AC can then either proceed with the Change by Confirmation Notice (which is then paid for by Change Adjustment to the UC or by capital payment by AC where either AC so elects or where the PFI Company cannot obtain additional finance for the cost of the AC change. Alternatively, AC can issue a Cancellation Notice for the proposed Change (in which event AC is obliged to pay the PFI Company its costs for the abortive work in producing the Change Appraisal). See Clause 36.
- 6.2 The PFI Company can request a Change to the New Works Requirements, the Conceptual Design, the Project Roads, the O&M Requirements and the Conceptual O&M Proposals by serving a Change Notice. AC has an absolute veto for Changes to the New Works/O&M Requirements; changes that will reduce the quality of the solution; unsafe, illegal or non-industry practice changes; or changes which are likely to delay PTU beyond the Scheduled PTU Date. Certain very minor Changes by the PFI company to not require AC approval. All other PFI Company Changes will be notified to AC but consent will not be withheld or delayed. Any savings from a PFI Company Change are shared 50/50 with AC (to incentivise PFI Company innovation) while any costs increases are borne fully by the PFI Company. See Clause 37.
- 6.3 Discriminatory Changes in Law (i.e. those discriminating against the PFI Company or the Project itself) and Specific Changes in Law (i.e. those at variance with the New Works/O&M Requirements or relating specifically to the design, building, financing or operation of roads) are at AC's risk and the cost consequences are borne by AC. General Changes in Law (i.e. all remaining Changes in Law) are shared between AC and the PFI Company in terms of cost on the following bases (aggregated from PTU Date):

Aggregate Capital Expenditure	AC Share	PFI Company Share
<£0	0%	100%
>£0 and ≤ £500k	25%	75%
> £500k and ≤ £2m	50%	50%
> £2m and ≤ £2.25m	75%	25%
> £2.25m	100%	0%

- 6.4 Any savings from General Changes in Law will be netted off in calculating aggregate capital expenditure.
- 6.5 If a Change in Law prevents performance of the Operations or substantially alters the nature of the DBFO Contract and AC/the PFI Company cannot negotiate suitable changes within a set period (to be agreed) then the agreement will terminate and AC will pay Force Majeure termination compensation (see below) for a General Change in Law or AC Default Termination compensation otherwise. See Clause 28 for Changes in Law.

7. **Financial Provisions (Part 5)**

7.1 The key elements of the Payment Mechanism are set out in Schedule 7 and are:

- AC will pay a combined monthly payment of Unitary Charge (UC) calculated/reconciled annually from PTU and retaining 10% until NWFC (see paragraph 2.3 of this Summary).
- The UC will be made up of an Availability element (approx. 75%) to the extent that the road is available for use by the public (i.e. not closed unless within specific permitted situations) and a Usage element (approx 25%) based on the volume of traffic using the new A92.
- From that, a Performance Deduction (for the PFI company not meeting the O&M Requirements) may be made, up to a maximum of 7.5% of the Monthly UC, according to the number of Performance Failure Points racked up (for the previous Month) due to any failures in meeting performance standards.
- Indexation is applied to the UC at a minimum of 2.5%. Where the increase in the Retail Price Index (RPI) is > 2.5%, then 26.95% of the RPI increase above 2.5% is applied (as bid by the PFI Company to reflect the proportion of underlying UC costs susceptible to inflationary increase) to the UC, along with the minimum of 2.5%. For example if RPI moved to say 3.5% then the applicable indexation factor would be 2.5% + 26.95% of the additional 1% ie a total figure of 2.5% + 0.2695 x 1.0% = 2.77% approx.
- A Low Value Change Adjustment mechanism is also provided to avoid the expense of re-running and amending the financial model for every Change made. This applies to Changes of a value of less than £1.0m. For these changes, an estimate is agreed between ACC and the PFI Company of the Change Adjustment. When the financial model is next re-run the Change Adjustment is then properly calculated and a reconciliation is made of any under/over payment.
- In the event of introduction of user-paid tolls on the Project Roads or congestion charging on roads in Angus or Dundee which connect with the Project Roads then the usage element will be calculated for a 2 year provisional period extrapolating previous years' traffic growth on the Project Roads. Thereafter, the traffic banding will be adjusted to reflect the long-term (and by then ascertained) impact upon traffic on the Project Roads.

7.2 Refinancing is subject to a sharing mechanism "Refinancing Gain" occurs when the PFI company obtains new borrowing for the project finance at improved rates over those secured when the Contract was signed. The position is that AC is (in line with Central Government guidance) entitled to a 50% share of any Refinancing Gains. A compromise has, however been reached to exclude rescue refinancings (i.e. broadly where the PFI Company is in actual or imminent default of its funding agreement so that the primary purpose of the refinancing is not to provide a gain but, rather, to preserve the Project) from AC's prior consent and gain sharing requirements along with exempt refinancings (per Office of Government Commerce (OGC) guidance: changes in tax/accounting treatment, share issues etc. which are not truly refinancings by new funding), provided that the rescue refinancing does not increase the Council's potential termination compensation liability by more than 10%. See Clause 42.

7.3 (a) Value for Money review and (b) Internal Rate of Return (IRR) Clawback provisions have also been included on 5 yearly cycles after PTU to (a) secure continuous assessment of whether improved value for money could be achieved by innovation and (b) to recover 50% of "super profits" gained by the PFI Company subject to there being no double-counting with Refinancing and also subject to reconciliation of any super-profit recovery with under performance over the life of the Project. The Threshold Equity IRR (Internal Rate of Return on equity invested) figure above which super-profits are shared was negotiated to 22.5%. See Clauses 43 and 44.

7.4 An explicit Best Value requirement is also made upon the PFI Company to sit alongside AC's statutory duty of Best Value under the Local Government in Scotland Act 2003 but limited to reporting and customer satisfaction surveying in view of the other contractual mechanisms in place (e.g. Refinancing, Value for Money Review, IRR Clawback) which achieve the purpose of Best Value. See Clause 45.

8. Indemnities, Insurance, Relief Events and Force Majeure (Parts 6 and 7)

8.1 The PA makes provision for mutual indemnities in relation to third party claims, property damage and breach of statutory duty. Each party may involve itself in the conduct of claims which are the subject of the indemnity but are presented against the other party (to allow the indemnifying party to mitigate the extent of its liability under the indemnity) but subject to the indemnifying party meeting any increased costs in defending the claim as a result of that intervention. See Clause 47.

8.2 Insurance requirements for the New Works and O&M periods of the Contract are stated in Schedule 10. The PFI company is obliged to maintain and pay for these insurances. Due to the volatility of the insurance market, however, and to maintain value for money for AC in the light of unpredictable long-term insurance costs, a cost-sharing mechanism between AC and the PFI company has been provided. This "insurance benchmarking" provision operates as follows:

- The actual cost of placing the O&M insurance requirements will be identified at the beginning of the O&M phase and fed into the UC accordingly at that time (on an open book basis)
- Insurance costs will be reviewed on a 5 yearly basis thereafter and benchmarked on an open book basis against the market prices then pertaining.
- The risk of premium price changes will be shared between AC and the PFI Company. The cost-sharing proportions have been negotiated as follows:

Insurance Cost Change (above or below the benchmark cost)	AC Share	PFI Company Share
£0-£15,000	25%	75%
£15,001-£30,000	50%	50%
£30,001-£45,000	75%	25%
above £45,000	100%	0%

8.3 The consequence of Uninsurability (a required insurance that becomes unavailable or not generally insured for in the roads PFI industry within the European insurance market) is that AC has an option to either self insure or terminate and pay force majeure termination compensation. See Clause 48 for insurances.

8.4 Relief Events are defined occurrences outwith the PFI Company's control the occurrence of which will provide the PFI Company with relief during the construction period from its obligations by the granting of an extension of time or, during the Operations phase (from PTU) relief from obligations to provide the operation and maintenance services. In either case, however, the PFI Company receives no payment while the Relief Event is continuing. Accordingly, the PFI Company will be granted relief in respect of time, but not money. Relief Events are defined but, in summary, are : insurable events, failure of statutory bodies, strikes or Angus Council changes or breaches. Force Majeure Events are more drastic defined occurrences which are outwith the control of either party and relief from liability is given to the affected party. In the case of the PFI Company, a Force Majeure Event may lead to frustration of the performance of the Operations. In simple terms, Force Majeure risks are those which are generally uninsurable or which may be commercially uninsurable e.g. war or terrorism. The PFI Company is entitled to relief from performance if a Force Majeure Event occurs but if the Force Majeure Event continues and the parties cannot agree an appropriate change to the DBFO Contract

or if it results in catastrophic damage to the Project Roads (sum to be agreed) then the PA will terminate and AC will pay Force Majeure termination compensation to the PFI Company. This reflects a “no fault” principle and as such shares the financial consequences to some extent. It amounts to the full Senior Debt outstanding, equity less dividends paid and subordinate debt less interest paid, breakage costs and redundancy payments (i.e. the PFI Company’s expected financial return over the life of the contract is not included). See Clause 49.

9. Default and Termination (Part 8)

9.1 AC can step-in and perform the Operations (or part of them) either on expiry of a default notice (where the PFI Company has failed to perform its obligations) or PFI Company default for safety/AC statutory duty reasons without notice. In either event, AC will be entitled to recover its costs. AC can also step-in without notice where performance of a statutory duty requires it again without default notice but without entitlement to recover costs. See Clause 50.

9.2 AC may terminate the contract on a PFI Company default and, in that event, no termination compensation is payable. In summary, the PFI Company defaults are:

- Failure to achieve PTU by the PTU longstop date – 45 months after signature of the Agreement (i.e. 30 June 2007).
- Accrual of 300+ Performance Failure Points (see para 5.2 above) for more than 3 months in any 12 month period.
- The PFI Company owing AC more than £100k which AC cannot set-off against UC payments for 20 working days after the due date
- Failure to maintain the required insurances
- PFI Company insolvency
- Fundamental breach by the PFI Company, including abandonment of the New Works for more than 2 months or ceasing to perform O&M for more than 1 month
- 5 (unchallenged or upheld) Default Notices in any 2 years
- breach of sub-contracting/assignment provisions
- Refinancing without notifying AC.

Except for PTU failure, PFI Company Insolvency and 5 accumulated Default Notices, the PFI Company is to be given an opportunity to rectify before termination applies. See Clause 52.

9.3 Termination by the PFI Company where AC is in default requires prior notice and multiple notices (reminder and final reminder) for non-payment. The default events are:

- AC breach such that it frustrates PFI Company performance for at least 6 months (period under discussion with funders).
- failure by AC to pay £300k or more (where not in dispute) for 1 month or more
- expropriation of PFI Company or Project Roads by AC, DCC or relevant authority (i.e. “nationalisation” or equivalent).
- Breach by AC of assignment/sub-contracting requirements
- Quashing of PA in judicial review or audit review (under Local Government (Contracts) Act 1997) as ultra vires.

See Clause 53.

9.4 Termination Compensation for AC Default is the full measure of loss for both the PFI Company and its Funders/shareholders including the PFI Company’s expected return for the full concession period remaining such that the PFI Company/Funder are no worse off than if the PFI Contract had continued to its full term. See Schedule 11 for the calculation of Termination Compensation.

10. Miscellaneous (Part 9)

10.1 Confidentiality: the presumption is in favour of confidentiality with exceptions including:

- Information already in the public domain
- Any disclosure required by Law (e.g. under the Freedom of Information (Scotland) Act 2003) or Court Order
- Disclosure to DCC
- Disclosure to government

See Clause 60.

10.2 Disputes Resolution – a fast-track procedure is provided for all disputes under the Agreement (Schedule 8) except in relation to disputes over termination (which go to Court). Clause 61 calls up Schedule 8.

10.3 Termination for Corrupt Gifts and Fraud – the PFI Company is still entitled to limited termination compensation in this event for Senior Debt and breakage costs only in accordance with OGC guidance. See Clause 64 and Schedule 11.

10.4 Assignment and Sub-contracting: PFI Company may not assign the agreement without AC's prior consent other than by way of securing under the Funding Agreement. Sub-contracting by the PFI Company is also controlled by AC. AC's right to assign is limited to only local or central government or a body whose obligations are underwritten by AC or competent government, even should assignment be by operation of law. This is important to the PFI Company and the Funders as they rely on the strength of AC's covenant as security for the UC payment stream. See Clause 65.