

High Court ruling places another question mark over PFI waste projects



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A RECENT CASE INVOLVING WASTE RECYCLING and treatment facilities could have significant implications for the future procurement of large-scale waste treatment and disposal plant and for lenders to Private Finance Initiative (PFI) projects. The case raises serious questions, albeit that such questions remain unresolved after this case, about the primacy of security arrangements where PFI assets become affixed to land owned by an authority.

The ruling in question (*Governor and Company of the Bank of Scotland v Neath Port Talbot District Borough Council and another*) was actually no more than the outcome of a preliminary hearing, held prior to consideration of the main action brought by a bank against a County Borough Council. At the hearing, Richards J (sitting in the Chancery Division of the High Court) approved an interim application by the council for the expedited sale of waste recycling assets, which were the subject matter of the bank's substantive claim in the main action and alleged by the bank to be subject to charges in its favour.

Those involved in the municipal waste sector will know that the provision of facilities to treat municipal waste – or, more to the point, the lack of them – is close to a crisis point. Whilst PFI has been touted as a panacea, in reality the number of large-scale PFI waste projects to reach financial close has been limited, partly because of the complications associated with waste.

BACKGROUND FACTS

Neath Port Talbot County Borough Council (the council), as a waste disposal authority, was under a statutory duty to arrange for the disposal of household, industrial and commercial waste. It owned the freehold of a site in South Wales (the facility), at which a private sector contractor (the company) provided waste recycling services pursuant to the terms of a PFI contract, entered into between the council, the company and others in October 2000. Funds to build and operate the facility were advanced to the company by the Bank of Scotland (the bank) and the council granted the company a lease of the site. The council was under no liability in respect of the bank's advances.

The company failed to provide a service capable of handling the daily tonnage of waste for which it had contracted and there were repeated operational difficulties with the waste recycling assets, plant and equipment at the site (the equipment), which meant that the contracted services were not being provided. Ultimately, the council felt it had little option but to serve a notice terminating the PFI contract and, from about October 2005 onwards,

the facility was operated by a company wholly owned by the council. The private sector company went into administration, owing the bank over £40m. As part of the loan package, the bank had been granted security over the equipment (in the form of a debenture dated October 2000 and a chattel mortgage dated June 2005), which the bank now sought to enforce.

The principal area of dispute in the main action brought by the bank was the legal effect of the steps taken by the council. The council asserted that the effect of the termination notice under the PFI waste contract was to terminate the lease of the site, vest the equipment free of the bank's charges in the council, entitle the council to appoint a new service provider and trigger the rights of the company (which had also been charged to the bank) to claim compensation from the council.¹ The bank, on the other hand, whilst seemingly not disputing the termination of the lease, strenuously resisted the contention that its charges over the equipment had been terminated. It was during the early stages of proceedings to determine these matters that the council chose to make its interim application.

COUNCIL'S PREDICAMENT

Ultimately, the council chose to apply to court because it found itself in an invidious position: it had to seek a practicable alternative long-term solution to the provision of waste services within as short a period as possible. The obvious options available to the council were either to shut down the facility and completely replace the equipment, or to upgrade the equipment to resolve its longstanding deficiencies. Neither option, it had concluded, would be particularly attractive to new service providers in the PFI waste market.

Attractive alternatives did, however, exist. Permission had already been granted for the expansion of the facility, which would benefit from substantial EU funding so long as strict deadlines were met.² Further, the council had been coming under increasing political pressure locally to integrate itself into the Regional Waste Strategy (RWS). Doing so would entitle it to additional funding from the Welsh Assembly. Further, an expanded facility would have spare capacity, which could also be included in the RWS. However, there was a limited window of opportunity to join the scheme.

The council felt that running a replacement waste procurement process in circumstances where it could not be certain of giving good title to the equipment was not a feasible option. The judge summarised the council's arguments thus:

‘... to offer the project to the market on the basis that the equipment may or may not be available, depending on the outcome of the case, is commercially hopeless.’

Besides, the council wanted to offer potential bidders the option of acquiring the facility with the existing equipment, in order that they might make their own decision as to whether or not to use it.

In the meantime, however, there was an ongoing need to provide waste recycling services as effectively as circumstances allowed. The council concluded that it was in the public interest to continue using the facility with the existing equipment pending completion of the replacement procurement process. The quicker such a process could be concluded, however, the better – the continued use of the facility with the inadequate equipment was substantially more expensive to the council than the cost of disposal through the traditional route of landfill.³

APPLICATION TO COURT

An impasse had therefore been reached – for a variety of reasons, the council wished to act as quickly as possible, whereas the bank was happy to wait until the issues came to trial.

The council therefore decided to apply to Court for an order for the sale of the equipment pursuant to Part 25.1(1)(c)(v) of the Civil Procedure Rules, which gives a court the discretion to order:

‘... the sale of property which is of a perishable nature or which, for any other good reason, it is desirable to sell quickly.’

Despite the fact that the council would have been free to deal with the equipment if (as it argued) the bank’s security interests had indeed fallen away, the council chose to concede, for the purposes of the application at least, that the bank did indeed have an arguable case that it retained the benefit of charges over the equipment.

The goods in question not being of a perishable nature, the success of the council’s application

turned on the Court’s assessment of whether ‘other good reason(s)’ existed to order the sale and, if so, whether the Court should in fact exercise its discretion to make such an order.

Despite submissions to the contrary by counsel on behalf of the bank, the Court was persuaded that the factors leading the council to seek to carry out the replacement procurement process promptly were sufficient to meet the threshold requirement of the existence of good reason(s). It then proceeded to evaluate the further reasons submitted by the parties as to whether it should in fact exercise its discretion to order a sale.

ARGUMENTS BEFORE THE COURT

The council’s submissions partially reiterated its earlier rationale for requesting the sale, but were essentially that if no order was made and it subsequently prevailed at trial of the main action:

- it would fail to qualify for the EU funding, without which expansion of the facility ceased to be an attractive option;
- its ability to market the facility to bidders would be severely compromised;
- the losses at the facility due to use of the inadequate equipment would continue for much longer than would be the case if a replacement procurement process was begun promptly;
- there would be a delay in rectifying or replacing the defective equipment; and
- the opportunity to integrate itself and the facility into the RWS would be lost to the council.

The council further argued that it would not be adequately compensated for such losses even if it prevailed at trial and, further, that certain of its losses (both to itself and to the public interest it served) would not, in any event, be capable of financial compensation, such as the inability to integrate into the RWS and the interim loss of non-landfill waste disposal capacity.

In response, the bank argued that its charges over the equipment gave it the right to sell at the time and in a manner of its own choosing. The bank’s principal aim was inevitably to secure the highest possible purchase price, and it contended that this might best be obtained by carrying out an orderly international sales process. It also argued that the availability of compensation should not be regarded as an adequate substitute for the loss of the rights it alleged and that the council’s need to apply for a

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court order for expedited sale arose only as a result of the council's own previous delay.

JUDGMENT

While accepting that there was significant substance to the bank's allegation of council delay, the Court said it had to deal with the position as it then existed. Ultimately, it was not persuaded by the bank's arguments and ordered that the equipment be sold.

It did so, however, subject to the proviso that the terms of the order for sale adequately protected the bank's position. It therefore ordered that such a sale be conducted by a suitably experienced independent expert.

An interesting debate took place as to whether the bank should be allowed to take part in the bidding process. The bank's concern was to ensure that an appropriate sum was realised for the equipment and that, if it thought it could obtain a higher price through an extended process, it could acquire the assets and remarket them itself. The council in turn expressed its concerns that the bank might try to exploit the particular pressures on it to make a 'spoiling bid' which was uncommercially high.

The Court struggled with this issue, but ultimately allowed the bank to bid, while also giving the council the right (which it subsequently made use of) to apply to court to have any successful bank bid disallowed if it was held not to be a genuine bid at market value.

CONCLUSIONS

In his closing remarks, the judge commented that:

'... the decisions as to what, if any, order to make... involves the balancing of a number of legitimate competing interests. There is no perfect solution. I have aimed to produce a result which is, in all the circumstances, fair.'

In deciding to grant the order, the Court concluded that, whereas compensation would not be an adequate remedy for the losses that the council was likely to suffer if it succeeded at trial without an immediate order for sale, the converse was not true – the bank's rights were ultimately of a financial nature and could be satisfactorily compensated financially should the bank prevail at trial.

Unfortunately, at least as far as the interested legal onlooker is concerned, that trial never took place, since the bank decided to discontinue its action. In many ways this is a shame – very few PFI cases reach court. A judgment on the security issues in

dispute in the main action would have been very instructive, although it could have been quite damaging to the PFI sector. Various questions that would presumably have been examined, such as whether the rights of a funder of a PFI project are, on termination, in effect, no more than rights to compensation, will have to wait for another day. What can be learnt from the case, however, is that PFI assets are far from immune from the effect of applications for an expedited sale of assets.

Aside from the evident security concerns which now arise, there are various other conclusions that can be drawn from this interesting case. The Court appeared perfectly comfortable taking policy and political considerations into account in reaching its decision. Further, acknowledging that, in the greater scheme of things, a decision regarding ownership of the equipment was secondary to the effective provision of regional waste services, it determined that the council could not afford to wait for such an issue to be resolved if it were to discharge its statutory responsibilities adequately. Balancing the legitimate policy considerations (such as the desirability of securing EU funding) and the public interest that the council was bound to take into account, together with the growing political pressure being exerted upon the council to integrate itself into the RWS, against the bank's financial interests in the equipment, it concluded that the bank would not be unduly prejudiced by a decision to order the sale.

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NOTES

- 1) The right to compensation is a standard PFI provision to ensure fair treatment of the contractor, on early termination of a PFI contract, if it has installed and paid for assets which transfer to the ownership of the authority on termination.
- 2) The deadlines required a PFI provider to have started by 20 November 2006, the very same date as the trial of the main action was due to take place.
- 3) One might ask why the council did not decide to stick with landfill. However, over the next few years, EU and UK laws will oblige councils to divert municipal waste in large quantities away from landfill, so this would not have been a long-term solution.