House of Commons

Committee of Public Accounts

HM Treasury: Tendering and benchmarking in PFI

Sixty–third Report of Session 2006–07

Report, together with formal minutes, oral and written evidence

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The Committee of Public Accounts

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The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at http://www.parliament.uk/pac. A list of Reports of the Committee in the present Session is at the back of this volume.

Committee staff

The current staff of the Committee is Mark Etherton (Clerk), Philip Jones (Committee Assistant), Emma Sawyer (Committee Assistant), Pam Morris (Secretary) and Alex Paterson (Media Officer).

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Summary

Under the Private Finance Initiative (PFI) there are now 800 contracts with private sector suppliers for services worth in total £155 billion up to 2032.[1] To achieve value for money, all stages of a project have to be managed effectively, including the tendering process, when procuring authorities invite tenders and select a winning bid for the contract. In 2003 we highlighted a number of issues regarding the PFI tendering process and concluded that the taxpayer was not always getting the best deal from PFI contracts because good procurement practice was not being followed.[2]

Four years later these concerns remain and the Treasury has done little to apply what it has learned from the large number of PFI deals that have now been signed. There has been no improvement in tendering times, significant risks to value for money continue to be taken when public authorities make late changes to deals, and there is a continuing lack of skills and experience in public sector PFI teams. As a result, there are signs that market interest is weakening, with fewer serious bids for recent deals.

The cost of ongoing services provided under the PFI is a significant element in overall costs and in the value for money of deals which may run for up to 35 years. Most contracts include provisions for testing the value of services such as catering or cleaning, typically every five to seven years, by comparing information about the current service provider's provision with comparable sources (benchmarking) or inviting other suppliers to compete with the incumbent in an open competition (market testing).

The early experiences of these value tests show that PFI contractors are using these processes to secure price increases and that some authorities are cutting services to pay for them. There is also a lack of comparable data to check whether prices proposed by incumbent suppliers are competitive. So business cases for long-term PFI contracts, where services could be otherwise procured conventionally through short term contracts, need to be tested against a robust range of price scenarios, to show that the value for money case is insensitive to possible price increases.

On the basis of two reports by the Comptroller and Auditor General,[3] we examined whether the PFI tendering issues we highlighted in 2003 are being addressed and the early experiences of the small number of PFI projects that had carried out value testing up to summer 2006.

1 Committee of Public Accounts, Twenty-fifth Report of Session 2006–07, *Update on PFI debt refinancing and the PFI equity market*, HC 158, para 21

2 Committee of Public Accounts, Twenty-eighth Report of Session 2002–03, *Delivering better value for money from the Private Finance Initiative*, HC 764

3 C&AG's Reports, (1) *Improving the PFI tendering process*, HC (Session 2006–07) 149 and (2) *Benchmarking and market testing the ongoing services component of PFI projects*, HC (Session 2006–07) 453

Conclusions and recommendations

1. **Since 2004 the proportion of deals attracting only two bidders has more than doubled, with the risk of no competition if one bidder is weak or drops out.** Lengthy tendering periods and high bid costs are already cited by bidders as key reasons for greater selectivity, and new procurement regulations require a greater degree of bid development earlier in the process. Where only two detailed bids are forthcoming, project teams should investigate the reasons for the lack of interest, and departmental Private Finance Units should consider what lessons can be applied for future PFI deals.

2. **The average tendering time for projects in 2004–2006 was 34 months, compared to 33 months for projects that closed prior to 2004**. The average cost of advice was £3 million, reflecting the length of the process, and delays to projects cost the taxpayer at least £67 million. The Treasury should encourage departments to impose sector specific targets for the completion of deals and require the completion of post-signing project evaluations by project teams. A summary of the evaluations should periodically be published by the Treasury to help spread good practice and learn lessons for the future, for example, on the need to have the right skills and experience in the public sector team.

3. **One third of public sector teams made changes to PFI projects after they had selected a single, preferred bidder.** Although new procurement regulations may reduce the scope to make significant changes after the competitive process has ended, the practical effect of these regulations has yet to be tested. The Treasury and Departments should assess the impact of the new procurement regulations by mid-2008, including whether they have reduced the incidence of late changes to deals.

4. **Benchmarking and market testing, which might have been expected to improve prices during the contract period, have in practice increased prices by up to 14%.** The private sector has been able to negotiate price increases for the provision of existing services with more than half the local project teams examined. Such increases put at risk the value for money case for long term arrangements to provide facilities services such as catering and cleaning. Such arrangements should be avoided unless the value for money case can be shown to be insensitive to the sort of price increases (or equivalent service reductions) through the contract period that have already occurred on other projects.

5. **Public authorities have found it difficult to find appropriate data to benchmark PFI service costs, placing them at a disadvantage in price negotiations.** Incumbent suppliers will be in a strong position if authorities cannot place them under competitive tension. Partnerships UK (PUK) should bring to an early conclusion its current work to collect data on PFI benchmarkings and market testings. The Treasury should then work with departments to consider whether, taking account of the PUK data and other departmental cost databases, further cost data are needed to enable project teams to negotiate robustly on any future PFI value testing exercises.

6. **There is evidence that, faced with price increases, public authorities had to cut back on services in hospitals, including portering, to keep the contracts affordable.** Where such cutbacks have been made so far the authorities believed that they would not compromise the service to the users though cutting services could, in some situations, impact on users. Where reductions in services provided under PFI deals are agreed, they should be notified to the relevant departmental Private Finance Unit. The Treasury should review the results of user surveys to identify any evidence that such service reductions have put satisfaction in doubt.

7. **There is a continuing lack of PFI experience and skills within public procurement teams across the public sector.** One–third of procuring authorities admit that they have insufficient resources or in-house expertise for part or all of the PFI tendering process. The Treasury and the Office of Government Commerce should implement two linked changes to allow all complex procurements such as PFI projects to be staffed by people with relevant experience and skills:

    — the establishment of a career structure to create and retain a cadre of appropriately rewarded public sector procurement professionals, expert in complex procurement such as the PFI;

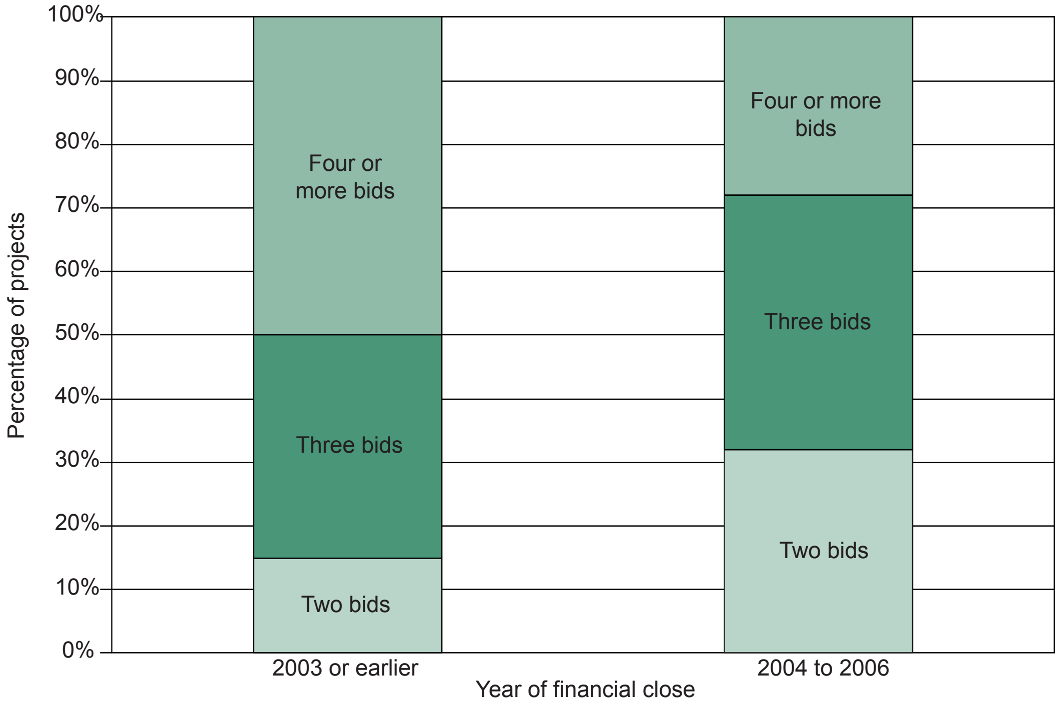
    — the development of a secondment model which would allow interchange between procurement experts in the public and private sectors.

1 Maintaining competitive tension in the tendering and value testing of PFI deals

Competitive tendering for new deals

1. If value for money is to be achieved and maintained, it is critical to have a functioning competitive market, yet the proportion of projects attracting only two viable bids has increased in recent years. Whereas 15% of projects that reached financial close in 2003 or earlier had attracted only two bids, this figure had more than doubled to 33% for those projects that closed between 2004 and 2006 (**Figure 1**).[4]

Figure 1: The proportion of projects attracting only two viable bids has increased in recent years



Source: National Audit Office

2. Lengthy tendering periods and high bid costs are discouraging bidders and there is a risk that low market interest may become a significant problem for future PFI deals. This risk could increase following the introduction in early 2006 of a new EU procurement procedure, known as Competitive Dialogue, which requires a greater level of agreement on contractual terms prior to the appointment of a preferred bidder and will increase overall tendering costs for losing bidders. The Competitive Dialogue procedure may also make it more common for procuring authorities to choose to go down to two bidders at an earlier stage, in order to reduce costs for both themselves and the private sector. While the presence of two bids still allows for competitive tension, there is a risk that it could be lost if one of the bidders drops out.[5]

4 C&AG's Report (1), paras 2.1, 2.2

5 C&AG's Report (1), paras 2.5, 2.7; Qq 85–86

3. The Treasury is monitoring the situation closely but, despite there being twice as many projects since 2004 attracting only two bidders, it did not believe there was a worrying shortfall of competition on bids. It saw no evidence to suggest that the falling number of viable bids was a result of collusion between private sector companies to agree on which projects to bid for, thereby reducing their outlay on unsuccessful bids.[6]

Competition in value testing of operational deals

4. Most PFI contracts have arrangements to test the value of certain ongoing services through either benchmarking or market testing, these processes being known collectively as value testing. The implications of inadequate competition, which can affect the tendering process, are also relevant to value testing. Market testing is usually preferable to benchmarking because it seeks new bids for services from alternative suppliers, rather than simply comparing costs with similar services provided elsewhere. There may, however, be situations where benchmarking should be used, for example where there is insufficient competition to run an effective market testing exercise.[7]

5. Two of the three market tests examined in the C&AG's report had resulted in price increases with uncertain value for money. None of the market tests had been won by a new external supplier although in one case the service provision had been taken back in-house. The process was deemed to be competitive in each case with alternative suppliers putting in bids. The incumbent supplier is, however, often in a strong position to win the re-competition of a service contract as a result of its knowledge of the project and its relationship with the authority.[8]

6. If incumbent suppliers continue to win a high proportion of market tests, competition in future market tests could be discouraged, leaving the incumbents in a powerful position. They would then be likely to remain the supplier of services for the life of the PFI contracts, which may be as long as 35 years, with little incentive to improve the services they are providing. Recent data compiled by the Treasury showed that, where a number of services were being supplied within a PFI contract, some of the incumbent suppliers were exposed to competition. The Treasury's data identified that there had now been 13 market tests (on five projects, some of which had run separate competitions for a number of services) and the incumbent supplier on certain services had been replaced in six of the 13 tests. The Treasury is also working with Partnerships UK to facilitate a competitive market by publishing details of forthcoming competitions.[9]

7. If there are situations where project teams cannot secure strong competition through a market testing exercise then they will need to use benchmarking to test the value of services provided by an incumbent supplier. To replicate the competitive tension that arises in market testing, the public sector needs to be able to negotiate, based on good benchmarking data, on the terms offered by other suppliers for similar services. Although there are some departmental cost databases including non-PFI data, PFI projects have

6 Qq 3–4, 82–84

7 C&AG's Report (2) para 1.1; Figure 4; p 9

8 C&AG's Report (2), paras 2.8–2.11

9 Qq 23, 60, 77–78

often had difficulties, however, in finding comparable data to test whether the prices proposed by the incumbent supplier are competitive. In two of the four building projects examined in the C&AG's report which had completed benchmarking, the outcome had been a price increase, in one case as much as 14%, and the value for money of these price changes had been uncertain. Better benchmarking data, combined with more effective negotiations, might have produced improved outcomes in these cases. To assist situations where benchmarking is used, the Treasury had asked Partnerships UK to collect data from 55 projects in order to improve the adequacy of benchmarking information currently available to departments. Partnerships UK is planning to roll out this data collection process across the PFI programme.[10]

10 C&AG's Report (2), para 2.6; Qq 16–20, 22, 57, 60

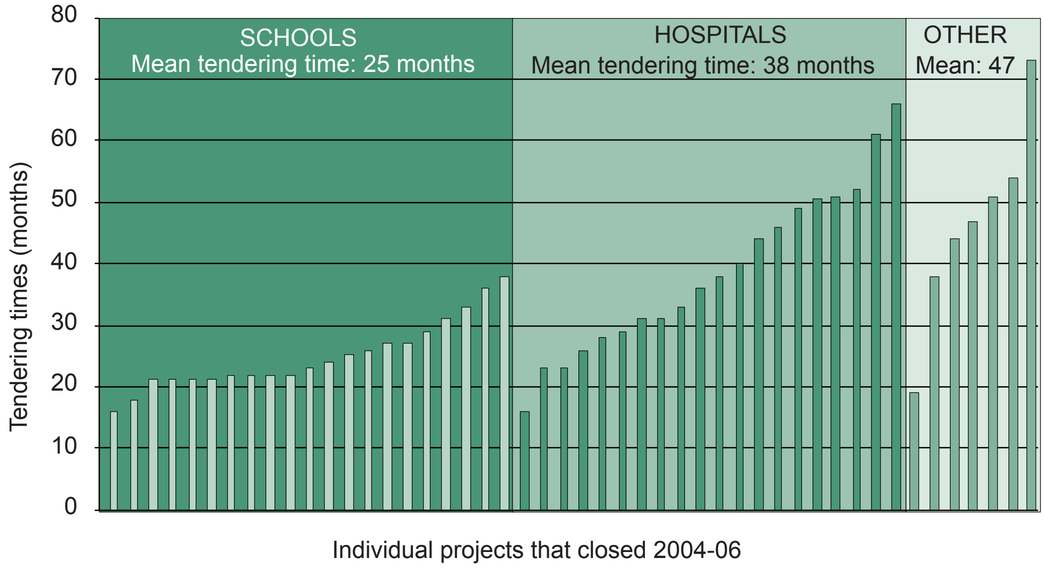
2 Time and cost implications of tendering and negotiations

Time taken to tender new deals

8. The average tendering time from initial advertisement to the close of a deal for PFI projects in 2004–2006 was 34 months, compared to 33 months for projects that closed prior to 2004, although there were significant differences even within sectors (**Figure 2**). The shortest overall tendering period was 16 months, whilst the longest was 73 months. The average cost of external advice for each project was £3 million, reflecting the length of the process, and delays to the schemes (as well as putting bidders off) cost the taxpayer at least £67 million in total.[11]

9. Such extended procurement periods and high costs highlight the complexity of negotiating PFI deals and the fact that reasons for delays are sometimes unforeseeable. The C&AG's report concluded that in most cases, the major causes of delay were either avoidable or could have been mitigated by the public sector without compromising value for money.[12]

Figure 2: The length of tendering varied widely within sectors



Source: National Audit Office

10. Causes of delay that could be avoided by the public sector include insufficient specifications prior to going to market, changes to the scope and design of projects, and poor process management. The Treasury agreed that its performance in working to reduce tendering times could be improved. However, it pointed to sector-specific delivery models such as Building Schools for the Future and Partnerships for Health, which have average tendering times of 22 and 20 months respectively, to demonstrate that there have been

11 C&AG's Report (1), paras 3.1, 3.2–3.24

12 C&AG's Report (1), para 3.7; Q 14

some signs of progress. Sector-specific targets had also been introduced in schools, street lighting and waste PFI deals.[13]

Time taken to value test operational deals

11. Some projects had completed value testing in between nine and 16 months but two projects had taken longer. In the case of an office accommodation project (St John's House, Bootle), the benchmarking process took just over two years because there was some difficulty in agreeing comparative data for the benchmarking exercise and the public sector rejected a proposed 16% price increase. Hereford and Worcester Magistrates Court had been trying to complete a benchmarking exercise for over three years because of difficulties in finding comparable data and there was little incentive for the private sector to complete the process since, at the time of the first benchmarking exercise, the contract only allowed for a price reduction. Generally, however, the public sector experience of the time taken to renew services within PFI contracts is very similar to that of non PFI contracts, where competitive tendering typically takes between six months and two years.[14]

Negotiations with a single bidder for a new deal

12. As PFI projects tend to be complex procurements, it is usual for the public sector to invite bids and then choose a single, preferred bidder with whom to negotiate in detail. Even if there is a strong competitive process during tendering or value testing, the way in which negotiations are handled by the public sector after the competition has ended can be crucial to the ultimate value for money of a PFI deal. One third of the projects examined in the C&AG's report on tendering made significant changes to the project scope during negotiations with a single, preferred bidder. On average, the value of these changes (both upwards and downwards) was £4 million per project per year, equivalent to 17% of the value of each project.[15]

13. In the past, public authorities have requested significant changes to the design solution, the addition or removal of major equipment components, changes to the agreed services to be provided and major changes to the agreed allocation of risk. The process of Competitive Dialogue now specifies that bidders can only be asked to 'fine tune, specify and clarify their bids' once the competitive phase has concluded. The Treasury told us that it was not desirable for changes to be made after competitive tendering had ended but considered that the introduction of the Competitive Dialogue process would dramatically reduce the period where there was only one bidder (**Figure 3**), although it was too early to say whether total tendering times would also reduce.[16]

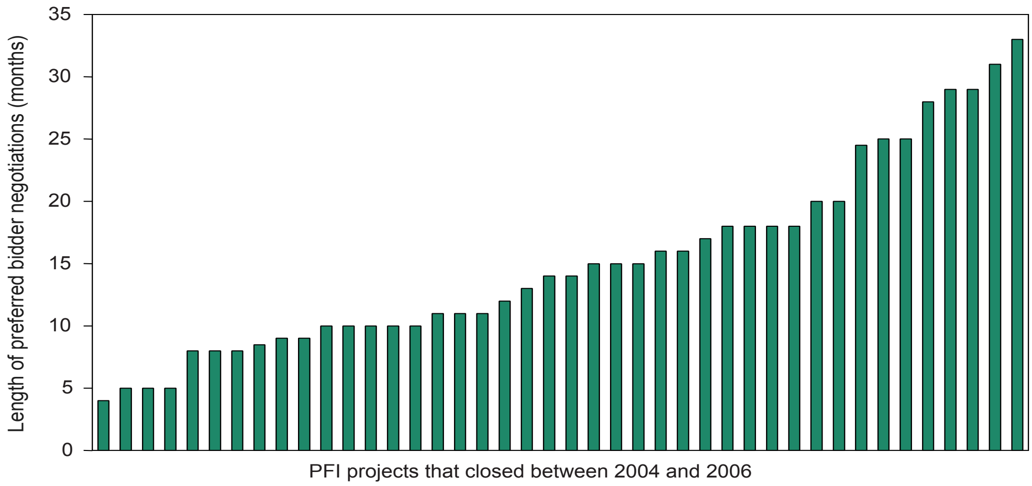
13 Qq 9–10, 63, 72

14 Qq 48–49; Ev 13

15 C&AG's Report (1), paras 3.27–3.29

16 Qq 14, 62–63, 85–88, 130; C&AG's Report (1), paras 1.6, 3.29

Figure 3: Preferred bidder negotiations for projects were often lengthy



Source: National Audit Office

Negotiations following the value testing of operational deals

14. The Treasury expects public authorities to decide, on a contract by contract basis, whether to include facilities services in a PFI contract or to procure them through conventional outsourcing. In some cases, design issues may make it sensible for a construction company to both build PFI facilities and provide related services. In other cases, conventional outsourcing may allow greater competition between service providers. To date, however, conventional outsourcing has not been compared overall with the cost and quality experience of facilities services procured under the PFI.[17]

15. In all the building projects which had been subject to benchmarking or market testing, the public authorities have had to enter into negotiations to improve the price changes initially proposed by the private sector. In four of these seven building projects the final outcome after negotiation was still a price increase of between 1% and 14% in addition to the annual price increase for inflation allowed by the contracts. In these cases, it was uncertain whether value for money had been achieved (**Figure 4**) given that the other building projects had achieved price reductions or kept the price unchanged. It is possible, however, that some bidders may have initially set prices at below market rates knowing that price increases could subsequently be negotiated through the benchmarking and market testing process.[18]

16. During negotiations with suppliers as part of the value testing of services, some public sector authorities had agreed to reductions in the services being provided to keep the price of their PFI contracts affordable. These authorities considered the service levels were previously over-specified and did not expect the reductions in specifications to compromise the service delivered to the public, although it is too early to judge the outcome conclusively.[19]

17 C&AG's Report (2), para 4(xi), 2.15; Qq 22–23,58, 61,77–81

18 C&AG's Report (2), paras 2.3, 2.17; Qq 16–20

19 Qq 18–21, 53–55; C&AG's Report (2), paras 2.19–2.26

Figure 4: Key features of the seven PFI building projects that have completed value testing of their ongoing services

Project Name	Value Testing Method	Change in Supplier (after market testing)	Annual Cost of Services (2005-6)	Final Agreed Price Change (note)	NAO assessment of value for money	Service change
Debden Park High School	Benchmarking	n/a	£0.2m	+ 14%	Uncertain	
Queen Elizabeth Hospital, Greenwich	Market Testing	Incumbent	£5.7m	+ 6%	Uncertain	Some planned enhancements to service not taken up to keep contract affordable
Sussex Partnership NHS Trust	Market Testing	In-house	£0.9m	+ 5.7%	Uncertain	
University Hospital of North Durham	Benchmarking	n/a	£3.5m	+ 1.2%	Uncertain	
St John's House, Bootle	Benchmarking	n/a	£0.8m	No change	Yes	
Norfolk and Norwich University Hospital	Market Testing	Incumbent	£9.8m	- 2.2%	Yes	
Darent Valley Hospital	Benchmarking	n/a	£5.1m	- 2.4%	Yes	A reduced office cleaning regime and cessation of two dedicated porters for each operating theatre but the Trust does not expect this to adversely affect users. Reduction in service costs also achieved through separate decision, as part of the clinical strategy, to close a number of beds

Note: The price changes exclude service enhancements and also the effect on the costs of the NHS Trusts of the NHS Agenda for Change which would have happened regardless of the PFI value testing process

Source: National Audit Office

3 Skills and expertise in public sector teams

17. Although most PFI contracts are procured and managed by local authorities and NHS trusts or other locally-based teams, many of these projects are supported by central government funding. Major Departments have established Private Finance Units with a remit to support the development, tendering and on-going management of projects in their sectors. In its policy document, Strengthening Long Term Partnerships (2006), the Treasury recognised that many Private Finance Units were inadequate and needed strengthening.

18. Apart from Private Finance Units, there are a number of other organisations with a remit to improve PFI procurement and operations. The Treasury takes the lead on policy development and chairs a Project Review Group that examines PFI projects before central government funding is provided. The Office of Government Commerce has a general remit to improve procurement across government, including complex procurement, co-ordinates the Government Procurement Service, and carries out Gateway Reviews at various stages in project procurement. Other organisations with a remit to improve PFI procurement and contract management include Partnerships UK and, within the local authority sector, the Public Private Partnerships Programme.[20]

19. Nevertheless, there is a continuing lack of PFI skills and expertise across the public sector, particularly in local authorities, NHS trusts, and other locally-based teams where officials are usually encountering PFI negotiations for the first time. The Treasury accepted that this was a major issue, and had sought to provide support through an Operational Task Force run by PUK, providing skilled secondees to local authorities, and the development of centralised programme management through bodies such as Partnerships for Schools and Partnerships for Health.[21]

20. While it did not have the remit to carry out any capability assessments of local authorities, the Treasury considered that the best authorities were those which had undertaken more than one procurement. Leeds City Council was cited as an example. Although its first PFI deal ran into a number of problems during the procurement, its last four deals were all tendered within 18 months with adviser costs within budget. The Director of the Council's Public Private Partnerships unit considered that the build up of expertise had enabled it to develop a better understanding of when and how to use external advisers, how to put together a project specification, and a greater commercial awareness leading to more focused negotiations with the private sector.[22]

21. This experience is not typical, however, and one-third of procuring authorities admit that they have insufficient resources or in-house expertise for part or all of the tendering process. A barrier to the development of this expertise is the fact that experience is not shared as widely as it could be because there is no systematic way of ensuring that lessons are shared within and across sectors. Greater recycling of experience across the public

20 C&AG's Report (1), Figure 2; Q 89

21 Qq 6, 28, 30, 37–41, 71

22 Qq 6, 41–43; C&AG's Report (1), case example 4

sector could also lead to savings in the cost of advisers, which were on average 75% higher than budgeted on PFI projects which had closed between April 2004 and May 2006.[23]

22. Good negotiating skills are essential if public sector officials are to secure good deals from private sector counterparts who are usually experienced in developing and managing PFI projects. For example, project teams which had undertaken the initial benchmarkings and market testings had identified the need for negotiation skills to challenge price increases proposed by the contractors, which were up to 26% in addition to the annual price increases for inflation allowed by the contracts. The Head of PFI policy at the Treasury, who had until recently been employed as a private sector adviser to public authorities, told us that the quality of individual public sector project teams was mixed. There had, however, been improvements in recent years and the Ministry of Defence's Private Finance Unit was an example of this improvement. Public sector procurements could also be improved through the greater transfer of existing PFI procurement skills across public sector bodies. The Office of Government Commerce, as part of the reform of the Government Procurement Service, was in the process of creating a secondment model which would facilitate this.[24]

23. Timely and appropriate guidance can assist public authorities in procuring and managing PFI projects effectively. Detailed Treasury guidance on value testing was not, however, issued until October 2006 after the initial value tests had already taken place. But even the growing body of written guidance that now exists on how to procure and manage PFI deals is no substitute for practical experience and training to equip local officials with the necessary skills.[25]

23 C&AG's Report (1), paras 2.9, 3.13, 3.23; Q 130

24 Qq 20, 25–26; C&AG's Report (2), para 2.21

25 Qq 18, 53–54, 74–76; C&AG's Report (2), paras 3.1, 3.5

Formal minutes

Wednesday 10 October 2007

Members present:

In the absence of the Chairman, Mr Alan Williams was called to the Chair

Mr Richard Bacon
Angela Browning
Mr David Curry
Mr Philip Dunne
Mr Austin Mitchell
Mr Don Touhig

Draft Report

Draft Report (HM Treasury: Tendering and benchmarking in PFI), proposed by the Chairman, brought up and read.

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

Paragraphs 1 to 23 read and agreed to.

Conclusions and recommendations read and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Sixty-third Report of the Committee to the House.

Ordered, That the Chairman 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 until Monday 15 October at 4.30 pm.

Witnesses

Wednesday 20 June 2007

List of written evidence

List of Reports from the Committee of Public Accounts 2006–07

First Report	Tsunami: Provision of support for humanitarian assistance	HC 25 (Cm 7018)
Second Report	Improving literacy and numeracy in schools (Northern Ireland)	HC 108 (Cm 7035)
Third Report	Collections Management in the National Museums and Galleries of Northern Ireland	HC 109 (Cm 7035)
Fourth Report	Gas distribution networks: Ofgem's role in their sale, restructuring and future regulation	HC 110 (Cm 7019)
Fifth Report	Postcomm and the quality of mail services	HC 111 (Cm 7018)
Sixth Report	Gaining and retaining a job: the Department for Work and Pensions support for disabled people	HC 112 (Cm 7019)
Seventh Report	Department for Work and Pensions: Using leaflets to communicate with the public about services and entitlements	HC 133 (Cm 7020)
Eighth Report	Tackling Child Obesity—First Steps	HC 157 (Cm 7020)
Ninth Report	The Paddington Health Campus Scheme	HC 244 (Cm 7076)
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Fourteenth Report	Ministry of Defence: Delivering digital tactical communications through the Bowman CIP Programme	HC 358 (Cm 7077)
Fifteenth Report	The termination of the PFI contract for the National Physical Laboratory	HC 359 (Cm 7077)
Sixteenth Report	The Provision of Out-of-Hours Care in England	HC 360 (Cm 7077)
Seventeenth Report	Financial Management of the NHS	HC 361 (Cm 7077)
Eighteenth Report	DFID: Working with Non-Governmental and other Civil Society Organisations to promote development	HC 64 (Cm 7077)
Nineteenth Report	A Foot on the Ladder: Low Cost Home Ownership Assistance	HC 134 (Cm 7077)
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Twenty-first Report	Progress in Combat Identification	HC 486 (Cm 7151)
Twenty-second Report	Tax credits	HC 487 (Cm 7151)
Twenty-third Report	The office accommodation of the Department for Culture, Media and Sport and its sponsored bodies	HC 488 (Cm 7152)
Twenty-fourth Report	Ofwat: Meeting the demand for water	HC 286 (Cm 7151)
Twenty-fifth Report	Update on PFI debt refinancing and the PFI equity market	HC 158 (Cm 7152)
Twenty-sixth Report	Department for Work and Pensions: Progress in tackling pensioner poverty—encouraging take-up of entitlements	HC 169 (Cm 7152)
Twenty-seventh Report	Delivering successful IT-enabled business change	HC 113 (Cm 7216)
Twenty-eighth Report	ASPIRE—the re-competition of outsourced IT services	HC 179 (Cm 7216)
Twenty-ninth Report	Department of Health: Improving the use of temporary nursing staff in NHS acute and foundation trusts	HC 142 (Cm 7216)
Thirtieth Report	The Modernisation of the West Coast Main Line	HC 189 (Cm 7216)
Thirty-first Report	Central government's use of consultants	HC 309 (Cm 7216)
Thirty-second Report	The right of access to open countryside	HC 91 (Cm 7216)
Thirty-third Report	Assessing the value for money of OGCbuying.solutions	HC 275 (Cm 7216)
Thirty-fourth Report	Recruitment and Retention in the Armed Forces	HC 43 (Cm 7216)
Thirty-fifth Report	BBC outsourcing: the contract between the BBC and Siemens Business Service	HC 118 (HC 1067)
Thirty-sixth Report	Reserve Forces	HC 729 (Cm 7216)
Thirty-seventh Report	Child Support Agency: Implementation of the Child Support Reforms	HC 812 (Cm 7216)
Thirty-eighth Report	Sure Start Children's Centres	HC 261 (Cm 7216)
Thirty-ninth Report	Preparations for the London Olympic and Paralympic Games—risk assessment and management	HC 377 (Cm 7216)

Fortieth Report	Dr Foster Intelligence: A joint venture between the Information Centre and Dr Foster LLP	HC 368 (Cm 7216)
Forty-first Report	Improving procurement in further education colleges in England	HC 477
Forty-second Report	The Shareholder Executive and Public Sector Businesses	HC 409
Forty-third Report	The Restructuring of British Energy	HC 892 (Cm 7216)
Forty-fourth Report	Tackling Anti-Social Behaviour	HC 246 (Cm 7216)
Forty-fifth Report	Standard Report on the Accounts of HM Revenue and Customs: VAT Missing Trader Fraud	HC 250 (Cm 7216)
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Oral evidence

Taken before the Committee of Public Accounts

on Wednesday 20 June 2007

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon
Mr Austin Mitchell
Dr John Pugh
Mr Alan Williams
Derek Wyatt

Sir John Bourn KCB, Comptroller and Auditor General, and **Mr David Finlay**, Director of PFI Development, National Audit Office, were in attendance and gave oral evidence.

Ms Paula Diggle, Treasury Officer of Accounts, HM Treasury, gave evidence.

REPORTS BY THE COMPTROLLER AND AUDITOR GENERAL

IMPROVING THE PFI TENDERING PROCESS (HC 149) and BENCHMARKING AND MARKET TESTING THE ONGOING SERVICE COMPONENT OF PFI PROJECTS (HC 453)

Witnesses: **Mr John Kingman**, Managing Director, Public Services and Growth Directorate (PSG), **Mr Jeremy Pocklington**, Team Leader, Corporate and Private Finance Team (CPF), PSG Directorate, **Mr Gordon McKechnie**, Head of PFI Policy, Corporate and Private Finance Team, PSG Directorate, HM Treasury; and **Mr James Stewart**, Chief Executive, Partnerships UK, gave evidence.

Q1 Chairman: Good afternoon. Welcome to the Committee of Public Accounts where today we are considering the Comptroller and Auditor General's Reports, *Improving the PFI tendering process* and *Benchmarking and market testing the ongoing service component of PFI projects*. We welcome John Kingman who is the Managing Director for Public Services and Growth Directorate from HM Treasury. Perhaps you might go through your colleagues, Mr Kingman, I think it might be easier that way rather than me just reading them all out.
Mr Kingman: With pleasure. On my left, James Stewart, Chief Executive of Partnerships UK (PUK); on my immediate right, Jeremy Pocklington, Head of our Corporate and Private Finance Team; and on my extreme right, Gordon McKechnie, who has recently joined us as our new Head of PFI Policy from Deloitte.

Q2 Chairman: Perhaps you might start by looking at paragraph 2.7 of the Comptroller and Auditor General's Report, the cost of all this. Mr Kingman, why are you letting tendering costs rise so much they are putting so many bidders off the process in the first place? Is that not rather basic?
Mr Kingman: I do not think that we are in a situation where we are putting bidders off, but this is something we watch rather—

Q3 Chairman: You have got twice as many projects only attracting two bidders, so if one drops out you have a monopoly situation, you are putting people off. The fact is that only the most experienced people, people prepared to put up with a very long tendering process are now taking part. You have made the process so complicated that you are getting less and less competition.
Mr Kingman: This is something that we do watch very closely for good reason. I do not think we are in a situation where we are seeing worrying shortfalls of competition on bids, but obviously if we were in that situation that would be very worrying.

Q4 Chairman: You are not worried that twice as many projects are only attracting two bids?
Mr Kingman: As I say, we do watch that.

Q5 Chairman: You may be watching it, what are you doing about it?
Mr Kingman: I might ask my colleague, Mr Pocklington, to say something about that.
Mr Pocklington: Thank you, Mr Kingman. I think we are putting in place an agenda of measures that are designed to improve public sector procurement skills in order to improve and ensure—

Q6 Chairman: I am sorry, I will stop you there. We are now the most developed PPP market in the world, there are 800 projects that have already gone through the mill. Do we have to wait for another 800 projects before you get things right?
Mr Pocklington: I think we have already put in place a number of measures—

Q7 Chairman: You just told me that you are now making further changes. You are adding another patch onto the broken wine skin.
Mr Pocklington: The measures that we are putting in place are showing early signs of improving tendering times—

Q8 Chairman: After 800 projects?
Mr Pocklington:—in certain sectors. A recent example is the *Building Schools for the Future* agenda where I understand that the average tendering time is 22 months, significantly lower than previous tendering times for the schools.

Q9 Chairman: Have a look then, Mr Kingman, at paragraph 3.1, will you? Why are tendering periods for PFI projects taking just as long now as they did four years ago? Why have times not improved? Here you are, the most developed market in the world, 800 projects already under your belt and tendering periods take just as long as they do now as four years ago.
Mr Kingman: I think I should be clear with you, Chairman, we agree with the NAO that the performance described in this Report is not as it should be.

Q10 Chairman: No, it is a very bad Report, is it not?
Mr Kingman: I agree with the NAO that performance is not as it should be. I think it is not a correct reading of the Report that we have been, as it were, asleep on the job, we have done a great deal. We would like to see more progress. There are some early signs including, as Jeremy said, the *Building Schools for the Future* programme. I would also mention on their health programmes Partnerships for Health has completed 42 procurements with an average procurement time of 20 months and in a number of sectors we are putting in place targets to try and get this further down.

Q11 Chairman: Mr Stewart, is this not an indictment of what you were supposed to achieve seven years after you were set up?
Mr Stewart: I do not believe so.

Q12 Chairman: You were set up to accelerate development of procurement and implementation of public-private partnerships. Were you set up to do that seven years ago? Why have you not achieved what you were set up to do?
Mr Stewart: I think we have achieved a lot of what we were set up to do. The Report itself highlights the importance of a central body like PUK supporting both the Treasury, the central policy position and individual projects. To give you one example of the difference we have made—

Q13 Chairman: I am not interested in one example, you can always pick out one good example. I am interested in overall processes and, looking at this in the round, it does not seem to me as if you have achieved much in shortening tendering periods, which is what you were set up to do so that we might get more competition, more people applying and, therefore, lower costs.
Mr Stewart: I would like to pick up an example that covers the whole market, a lot of people think that the main objective of the introduction of standard contracts was to decrease procurement times; in fact, the overall objective was to improve the quality of documentation which to me is as important as the time taken to procure. I think another general example is what we have done across programmes in investment, like BSF and LIFT, where we have seen dramatic decreases in the procurement times and procurement efficiencies in both schools and primary healthcare centres.

Q14 Chairman: One aspect of PFI that we were told was a very good part was that it was going to create certainty but let us look at paragraph 3.29, shall we? We see there that one-third of project teams made major changes to their projects after a single bidder had been selected. Why did you not do more, Mr Kingman or Mr Stewart, to prevent this happening?
Mr Kingman: We agree entirely with the NAO that this is not a desirable situation. We are doing a number of things on this front, which I will ask Mr Stewart to describe, but I would say that the problem will be addressed by the new competitive dialogue process which will dramatically reduce that period where there is only one bidder in the frame.
Mr Stewart: I am sure we will come on to this later, but I think some of the reasons for cost increases are some of the reasons for delays. Although some of those reasons can be attributed to procurement teams, a lot of those reasons are, in fact, outside their control. For example, a project which is highlighted in this Report, the Bart's London Hospital which I was involved in, ten months of the delay was due to a planning intervention by the Mayor of London which not only increased some of the costs because of extra things that would need to be done but also introduced some delay.

Q15 Chairman: If you would like to have a look at figure 11, which you can find on page 18. It is the key features of the PFI projects that have value tested their services. Look along the columns there to "Final Agreed Price Change". Do you see that?
Mr Kingman: Which Report are we on, Chairman?

Q16 Chairman: *Benchmarking and market testing the ongoing services component of PFI projects*, page 18. Look along that column, "Final Agreed Price Change". Now you have got some reductions. If you look down, you see "Defence Fixed Telecommunications Service" and "Foreign and Commonwealth Telecommunications Network", you have got quite heavy reductions there, which is also good, but apparently that is in the communications field where prices are coming down anyway. Generally, you see that the trend is upwards. Why is that do you think?
Mr Kingman: I am not sure that is correct, that the trend is upwards. The NAO concluded that five of the nine were good value for money; four of the nine were uncertain. The one here that is a significant increase, the Debden Park High School, the NAO noted that the price increase was effected by other factors that were at play at the time.

Q17 Chairman: It is a pretty mixed record, is it not?
Mr Kingman: I am very content to accept the judgment of the NAO, that five of these were good value for money; four were uncertain.

Q18 Chairman: Let us look at benchmarking and market testing. These were obviously designed to restrain costs but, in fact, they have led to price increases. How does that, do you think, fit the picture that PFI is supposed to lead to certainty? The reference, if you want it, is benchmarking, paragraph 2.21.
Mr Kingman: As I say, Chairman, the question is, were the changes value for money? The judgment of the NAO was that in five out of the nine they were value for money and in four out of the nine they were uncertain.

Q19 Chairman: What went wrong with the four out of the nine then?
Mr Kingman: I am not sure anything did go wrong with the four out of the nine. It depends how you interpret the word "uncertain". You may wish to ask the NAO to unpack what they mean by "uncertain" but I am not sure there was—

Q20 Chairman: Perhaps the NAO could help us.
Mr Finlay: The situation is that there are some projects which achieve price decreases, not just the communications one, which you have already referred to, but some of the hospitals projects did get price decreases. In these other projects where a lot of the issue came down to negotiations, they were left with price increases so, given that some had achieved decreases, there was inevitably uncertainty about whether these other projects had price increases.

Q21 Chairman: Is it true if they have managed to limit price increases, they have only done so by reducing services? Is that right?
Mr Finlay: In some cases there has been some element of service reduction.

Q22 Chairman: Do you think that we have got adequate data to know the PFI services are value for money when there is a lack of data to compare them with conventional outsourcing?
Mr Finlay: The Report notes that at the moment there were difficulties in making those comparisons.

Q23 Chairman: What do you say to that, Mr Kingman?
Mr Stewart: I think we have all got to accept this Report looks at the first nine benchmarking and market testings and, in parallel with this Report, at PUK we have been asked by the Treasury to collect data on both benchmarking and market testing. That data will be used by the public sector to inform their value-testing exercises but also to provide information to the private sector to tell them when market testings are coming up so that we can encourage a supply market to develop.
Mr Kingman: Could I add, Chairman, the reason that we have moved from a policy that took benchmarking as best practice to one of market testings was precisely because we think that it will lead to more robust outcomes. That is a change which we made relatively recently and it is one that the NAO endorse and think likely to lead to benefit for them.

Q24 Chairman: Mr McKechnie, can I ask, you have come from the private sector, have you not?
Mr McKechnie: I do.
Chairman: Tell us whether we are right in thinking that the private sector in the last ten years has eaten us for breakfast, because our people tend to come and go, for instance, in the Health Service, trusts run their own PFI projects, often in the private sector you have got people with years of experience, much better paid and they stay for the entire lifetime of the project. What can we learn from the private sector in the public sector? As now you are poacher turned gamekeeper, what can we learn from you? This is a question not meant aggressively. We would like to get the benefit of your advice.

Q25 Derek Wyatt: It is just the natural tone.
Mr McKechnie: My experience of public sector procurement teams is, quite frankly, a mixed experience. I have seen some that are good and some that are under-resourced and not so good. I have to say that in recent years I believe I have seen some improvements in the public sector procurement teams. My experience mainly in recent years has been with the Ministry of Defence and I think that the establishment of the Private Finance Unit in the Ministry of Defence and more recently the appointment of the commercial director there has improved matters.

Q26 Chairman: I think the Ministry of Defence has quite a grip on things, has it not? It is much more centrally run. What lessons can be learned from that, say, with regard to the Health Service, for instance, or education? Do we give too much independence to individual trusts in negotiating these PFI projects? Should there be maybe more central direction and help, do you think?
Mr McKechnie: I think that it would help if there was a greater transfer of skills around the procurement bodies, so people who are actually doing the procurement have had experience of previous ones. I think that is one of the proposals that is put forward which the OGC and the new Government Procurement Service are intending to do, to create a secondment model in order to achieve that.

Q27 Derek Wyatt: Good afternoon. I am interested, looking at this Report, *Improving the PFI Tendering Process* that there are three main people from the National Audit Office assisted by three others, that maybe four and a half people can write a Report to tell you what is going wrong. Rather than ask Deloitte's, why do you not just nick a few people from the National Audit Office because very quickly they are able to pinpoint what is wrong with the PFI system?
Mr Kingman: We are very happy to garner talent from wherever we can get it, but I think that we need—and it is something we have discussed at a previous hearing—in the Treasury, precisely as the Chairman put it, poachers turned gamekeepers,

people who can ask the right questions and know how to make sure that we are not going to get eaten for breakfast by the private sector.

Q28 Derek Wyatt: Is there some reason why you do not give this PFI process out to the private sector to manage?
Mr Kingman: In some respects we do, in the sense that we have Partnerships UK which is, as you know, a joint venture with the private sector. In the end the Government's policy has to be made by the Government and I think it would be risky to—

Q29 Derek Wyatt: Any riskier than the Thames Gateway?
Mr Kingman: I am not an expert on the Thames Gateway, but I think it is important to bear in mind the evidence is that PFI has delivered remarkably better results than conventional procurement overall.

Q30 Derek Wyatt: Since 1997 we have spent £70 billion on computer systems that have not worked in Government, so it would seem to me that there is a culture inside Government that does not really understand big projects. Why not use HSBC or Deloitte's or why not use them much more to handle these things?
Mr Kingman: I would be the first to agree that there are significant numbers of major projects, particularly IT projects, that have gone wrong. Most of them were conventionally procured projects not PFI. The reason that we set up OGC was precisely to have some serious private sector expertise to tackle these sorts of problems and I am really pleased that we have just attracted an excellent new commercial chief executive of OGC. We do have these skills but I do not think we can sub-contract policy decisions that are for Government and ministers to a private sector firm without losing value.

Q31 Derek Wyatt: Just reassure me, I had a PFI hospital that was in five small hospitals, a community hospital, in four different local authorities, a minefield, but it made lawyers and accountants very wealthy. What I did was I went to the Health Minister to ask if she could explain how it worked and she said it was a matter for Sheffield, and Sheffield would make the decision about the PFI. I then found that in the Treasury there was a health PFI specialist and I went across to see her. She said under no circumstances would they allow this PFI to go forward. It took 18 months in the Health Service for them to say, "This isn't a bad idea", but I already knew that the Treasury were going to say no. Please tell me that does not happen any more.
Mr Kingman: I would hope it does not happen very often. I am not aware of the details of the case obviously, but it does not sound very sensible.

Q32 Derek Wyatt: Do you have regular meetings with the PFI teams across Government?
Mr Kingman: Absolutely, yes.

Q33 Derek Wyatt: Regular, weekly? These are big projects that are going across. We have had one at Dartford, a brand new hospital that has gone broke already in the space of seven years, £100 million, I think.
Mr Pocklington: My team is in regular contact with PFUs around Whitehall.

Q34 Derek Wyatt: What does that mean, "regular"?
Mr Pocklington: Different members of my team would be in touch probably on a daily basis, members of PFUs have more structured meetings.

Q35 Derek Wyatt: I am trying to understand how the Treasury already knew they were not going to approve. Okay, it was only a £50 million thing, but it is still £50 million. How quickly do you tell the opposition, as it were, in Government, "This isn't stacking up, guys"?
Mr Kingman: I really do not know the details of the case.

Q36 Derek Wyatt: Forget that particular one, but there must be others where they go up in each department to the top silo man and then come across to you. The reason the delay is, I would maintain, there is bouncing going up and down the Department and they are trying to double-guess what you are thinking.
Mr Kingman: The situation described is not one we try to run at all. In the first instance, we would not tend to think of the Department as the opposition. What we try to do is have very close relationships with PFUs, precisely so you do not have this long bureaucratic process but so that departments understand clearly what it is that are the Treasury's principles which we set out in guidance and so on. Quite often they come to us and say, "We have got an issue. How do you think that might play out?"

Q37 Derek Wyatt: I think I have exhausted that one. What makes me as nervous is the lack of financial skills in local authorities, so what do you do? Do you actually say your own information—if it is confidential I understand—we have got to say, "Look, we have got league one players, we have got league two and league three. If we are going to give league two and league three players some PFIs, listen, we need to upskill that group"? If you say those sorts of things, what do you do to upskill the knowledge base of local authorities there?
Mr Kingman: As you know, we do not control local authorities.

Q38 Derek Wyatt: I know. One of the great criticisms is there is not enough skill in handling this at local authority level.
Mr Kingman: We would agree that is a major issue. What we have sought to do is, firstly, to give help and support through the Operational Task Force which local authorities have access to and, secondly, to

provide secondees so that a local authority that is doing something can get a skilled person to help them. James may want to add.
Mr Stewart: I think it is a challenging issue. In the world we live in local authorities are responsible and accountable for their own procurements and there is a tension when the centre tries to tell local authorities what to do. Some of the problems have certainly been overcome in the *Building Schools for the Future* programme where there is a strong central body that—

Q39 Derek Wyatt: It is huge amounts of money being released.
Mr Stewart: It is a £2.5 billion a year programme, so I think those sums are justified. Unfortunately, you have individual procurements going on in individual local authorities, if you are trying to provide the skills that you are talking about, it does not come for nothing.

Q40 Derek Wyatt: Are you able to put into the public domain those local authorities that have been to talk to you asking for advice in upskilling? Is that a confidential thing? I would like to get a better idea of which local authorities are any good. Could you provide a league table for us?
Mr Kingman: No, I do not believe we could. We certainly do not do any formal assessment of capability.

Q41 Derek Wyatt: Does the Audit Commission do that? Do you talk to the Audit Commission to say, "Listen, I know you analyse the local authorities into good, fair, weak and all that, but if it is weak and fair in this area, what goes in to help these local authorities get better?"
Mr Stewart: The answer is the best local authorities are those which have done more than one procurement and I think Leeds is highlighted in this Report as a Council that improved its performance over a number of PFIs. One of the initiatives in the *Building Schools for the Future* programme has been for Partnerships for Schools to arrange to capture skills in the local authority market and transfer them from one local authority to another. Unfortunately, a lot of the data that you are asking for is anecdotal rather than comes in any formal manner.

Q42 Derek Wyatt: You do not say, "Oh, goodness me, it is Kent again"?
Mr Stewart: Kent are quite good, they have done a number of procurements.

Q43 Derek Wyatt: Luckily, it is my authority. That is why I am asking.
Mr Stewart: They have done a number of procurements.

Q44 Derek Wyatt: In the various stages—the Chairman said it is getting longer and longer, or it is not getting shorter, the procurements thing—there is nothing you can do on-line, you cannot take three stages on-line confidentially and move them faster between departments and so on? Must this all be a paper and meeting process or is it on-line? Can you offer a confidential intranet system to help with the bidding process and the deal-making?
Mr Pocklington: I think there are a number of aspects in which the Treasury helps and assists and also holds local authorities to account. We have already discussed the important standard contract which is designed to improve the quality and consistency of PFI procurements across the public sector. The Treasury also runs the Project Review Group which is required to approve all local authority PFI projects and that provides us in the Treasury with an opportunity to scrutinise projects and the advisory teams at two stages in the lifecycle of a project.

Q45 Derek Wyatt: On-line?
Mr Pocklington: No, this is a real meeting with representatives from the project.

Q46 Derek Wyatt: There is nothing you can do using technology to speed up the process?
Mr Pocklington: We provide all our guidance on-line.

Q47 Derek Wyatt: I know, but I am thinking about filling in forms and getting the thing done, it is too complex.
Mr Kingman: I think the impression that it is all about forms and bits of paper is not the world I recognise really. This is more a world of personal relationships. The Operational Task Force, for example, is a phone-based system. I am very clear there are things that can be done to speed up the process, but I do not think the process problems we have here are really one of bits of paper moving around the system.
Derek Wyatt: Thank you, Chairman.

Q48 Dr Pugh: I could not help noticing—it is not very far away from me—that St John's, Bootle more or less broke the record for a benchmarking exercise lasting, I think, twice as long as the nearest competitor. I wondered whether you could tell us a little bit about what went wrong there because if benchmarking is a good thing, surely it ought not take that long to do?
Mr Kingman: I am not sure, I am afraid, there is anyone here who knows enough about that case. We would be very happy to send you a note about it. [1]

Q49 Dr Pugh: Could you send us a note on that? It would be useful. It would be surprising and obviously a very expensive exercise and if you also indicate in your note what the whole benchmarking exercise, if it lasted two years, cost. You mentioned quite voluntarily earlier *Building Schools for the Future*. Presumably, *Building Schools for the Future* includes not just simply the actual physical fabric of the schools themselves but some soft services as well, they are going to be involved too in the PFI contracts. Does the provision of soft services include, for example—because schools in the future

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are going to be quite different from schools in the past and they are going to have a very heavy IT role and so on—the supply of software or IT support?

Mr Stewart: One of the main objectives of that programme was to incorporate the integration of ITC into the design of the building and ultimately to improve educational standards so, yes, the ITC supply is an integral part of that. Two years into the programme Jim Knight, who is the Minister for Schools, has asked for Partnerships for Schools to look into that issue to see how it is going.

Q50 Dr Pugh: So it is an integral part so there will obviously be some fairly lengthy contracts involved for software services?

Mr Stewart: I am not convinced, but I will check, that it is actually the educational software; it is more the hardware, the wiring and the white boards.

Q51 Dr Pugh: What I am interested in is whether there will be provision for market testing that element of the PFI, because you can imagine that schools start off in a situation they are comfortable with and then they get told five or six years down the line, "I am sorry, it is time for an upgrade and you must have product X or supplier Y," and they cannot get out of it because there is no provision in the contract for benchmarking or market testing or outsourcing or any other alternative. Please assure me that is not the case.

Mr Stewart: That is not the case. To the extent that there is technology refresh it would be certainly one of those services which is benchmarked but, as I said, I think there is a very low educational software element.

Q52 Dr Pugh: In terms of soft service PFI provision of that, what is the average length of contract we are talking about for cleaning or catering, or whatever? What do schools and hospitals and so on sign up for, on average?

Mr Stewart: It is five to seven years.

Q53 Dr Pugh: And when they come to negotiate it, and I think it is specified in the NAO document, they are not in such a strong position, are they, because I think on page 12 of the Report on benchmarking it says that Nabarro looked at the robustness of the contracts and concluded that most of the benchmarking clauses and half of the market testing clauses were expected to have limited effectiveness . Why is that and what are we doing about it?

Mr Kingman: We agree that this is not a desirable situation that is described here. It is important to note that these were early contracts being looked at, and the NAO note in their Report that the quality of the contracts has improved since then, which is obviously important. I think it is important to bear in mind that whilst these contracts clearly were not as good as they could have been, in practice where authorities have had these contracts they have found ways to negotiate with contractors, and there is one such situation described in the Report.

Q54 Dr Pugh: If I were in a very weak legal position and I was going back to the contractor saying, "It is getting rather costly now or the amount you are demanding is more than we can afford," as seems to be happening in some places in hospitals and schools, I would imagine that I would be dependent upon a fairly compliant supplier who needed further business and needed to remain fairly amenable, but if I came across a supplier who wanted his pound of flesh it would seem fairly evident that unless the legal contracts are really robust he would get it, would he not?

Mr Kingman: I am not in any way defending contracts that are anything other than completely robust and I agree with the NAO that it is not desirable that Nabarro think these contracts were not tight enough.

Q55 Dr Pugh: One sign this was going on to a greater or lesser extent would be if a negotiation resulted in the person negotiating on behalf of the hospital or school realising that their position is weak, realising they have not got the money to pay the extra, realising they are in a fix, what they normally do is reduce the spec and they would actually ask for a little less from the contractor. Do you monitor that happening in PFIs? Have you got any figures on how many negotiations result in the person being provided with the service simply asking for less?

Mr Kingman: We certainly do monitor all PFI projects and indeed we publish data on them and I am going to ask James to say something about that in a moment. I just want to say there are case studies where bodies have had contracts that were not sufficiently tight but they nevertheless have managed to negotiate quite good arrangements. I am told there is the case of Victoria Dock Primary School which put in place an agreed profit-sharing scheme with the private sector that allowed them to take a share of the gains going forward.

Q56 Dr Pugh: Forgive me, I am sure there are anecdotes good and bad. What I really wanted to know is whether you could spot a general trend and one indicator that things were going really badly for people being provided with soft services under PFI would be a general trend to ask for a lesser spec as a way of getting by.

Mr Kingman: I do not think there is any general trend, partly because there have been so few of these benchmarking/market testing projects so far at the stage we are at in the programme.

Q57 Dr Pugh: You could not furnish any data on that now?

Mr Stewart: On benchmarking specifically, a typical benchmarking clause might say if the increase in the cost was beyond a certain figure then you have to go to market testing, so that is one of the protections that is built in the model. On the data front what we have been asked to do, as I said, is collect data. So far we have been to 43 project managers, which covers around 55 projects which we consider to be pilots, so the data is being collected, and one of the things we have held back on is going out to any more authorities because we wanted to actually have this hearing because we thought we might learn some thing from this hearing and that you might want some extra data, so following this hearing and following the consequences of this hearing we are proposing to roll out the collection of that data right across the programme.

Q58 Dr Pugh: Thank you but I do not think we do need more data! The NAO Report implies that the PFI solution is the preferred solution of Government policy and it says on page 7: "We are not, however, aware of any systematic overall comparison to date between the cost and quality experiences of facilities services procured under the PFI with conventional outsourcing"—a head-to-head comparison in other words. Have you go any evidence that PFI is a better way of doing things?

Mr Kingman: No, we actually take a rather careful position on this. There are situations where there is a case for using PFI for soft services but the Government is rather carefully neutral on this point, and indeed the documents that we published argue that our studies of the evidence suggest that PFI is neither preferable nor inferior to conventional outsourcing, and that is the evidence that we have had to date.

Q59 Dr Pugh: Okay, one thing you could have said and you have not said is that by having a PFI with an element of benchmarking you get a reduced price in terms of the initial bid that is accepted, but the NAO Report says that having benchmarking in the contract does not seem to afford much comfort to the supplier and does not reduce the overall contract price. You presumably agree with that?

Mr Kingman: We certainly agree that benchmarking is in general the less effective way of doing things and that is why we favour market testing as a better approach.

Q60 Dr Pugh: Does market testing make any difference to the bids coming in? If I have to sign up to a contract I am a supplier and it had a very robust market testing clause in it, that might make me have second thoughts and might make me put my initial price up rather than down.

Mr Kingman: Let me give you some figures on that. We are aware of 13 market tests that have taken place to date from our database and, of those, 46% of the incumbents have lost.

Q61 Dr Pugh: I was thinking more of the effect on the initial bid knowing what the contract is like. I admit that market testing is a more effective way of getting the price down when you are underway but there is a presumption that by allowing a reliable way of fixing of prices at a later date that affects the initial bid price.

Mr Pocklington: I think it is important looking back at the original bid price for the original contract for the PFI to take into account the competitive process under which these contracts are being signed. In our value-for-money guidance, the framework for which all PFI contracts are obliged to follow, the decision as to whether or not to include soft services has to be taken on an objective value for money basis.

Q62 Dr Pugh: Okay, my final question is specifically on the bidding process. You spoke earlier about the benefit of competitive dialogue as a way of bringing more people into the game, as it were, and it is supposed to reduce the length of the tendering process. Have you got any feeling for by how much the tendering process in terms of length of time will be reduced because of better dialogue?

Mr Stewart: I am not sure there is compelling evidence that it will reduce the tender times. I think it is designed to improve the quality of procurement. We will see whether it is going to reduce—

Q63 Dr Pugh: There are two indices, are there not, there is the question of whether it encourages more people to come into the game, and whether it reduces the actual tendering process. One reason why people do not bid sometimes is because of the length of the bidding process and they incur significant costs which may not be worth it if they do not get the contract in the end.

Mr Stewart: I do not think there is evidence either way. We are in the early days of competitive dialogue. What I can give you is some target procurement times for different sectors. *Building Schools for the Future* are targeting 19 to 22 months and the first four have come in at 22 months, although those were under the old procedure. Waste is now targeting 24 and street lighting is targeting 18 to 24. They will be under competitive dialogue but, as I said, I think it is really too early to go either way as to whether competitive dialogue will reduce or not; there are swings and roundabouts.

Dr Pugh: Thank you, Chairman.

Chairman: Thank you very much. Mr Mitchell?

Q64 Mr Mitchell: It looks to me as though, amiable chaps as you all are, you are desperately trying to hold a tiger by the tail. PFI/PPP—it is all a matter of ideology now and the Government wants it pushed and you can manage a little bit of control at the margins, but basically it all roars ahead and you lag behind and there is nothing much you can do about it.

Mr Kingman: I think that would be fair if the evidence did not show and the NAO studies did not show that PFIs delivered markedly better outcomes for the public sector than conventional procurement.

Q65 Mr Mitchell: It is not cheap though.

Mr Kingman: On budget, when in conventional procurement they are 75% over.

Q66 Mr Mitchell: On budget is a different matter. It is supposed to be providing the buildings and the developments more quickly and more cheaply and it is not.

Mr Kingman: I think we would say that it is.

Mr Mitchell: Well, here you have an area where greedy capitalists are invited into the public sector and given the freedom on the grounds that they are more competitive and these are chaps that know how to do it whereas the public sector is full of stupid people who do not know how to do it.

Q67 Chairman: You can smile by the way, it is a joke.

Mr Kingman: Thank you, Chairman.

Dr Pugh: There are no cameras.

Mr Mitchell: The dawn of socialism is next Thursday so let us not spoil it!

Derek Wyatt: Dream on!

Q68 Mr Mitchell: These firms are pretty skilled and they are well-advised and now they are very experienced and they can run rings around you, and more particularly around local authorities and hospital trusts and all the rest of it.

Mr Kingman: We require every PFI project to be assessed against a public sector comparator; that is to say in order for something to go ahead as a PFI it must be demonstrably better value for money than doing it through conventional procurement.

Q69 Mr Mitchell: Not at lower cost.

Mr Kingman: But better value for money and that is the test I would hope this Committee would want us to apply.

Q70 Mr Mitchell: Okay, but you have not been particularly diligent in trying to control it. Guidance on benchmarking and market testing, as the last NAO Report suggested, did not emerge until October last year. It does not seem there is a supreme rush to get control of this situation.

Mr Kingman: We are at early stages on benchmarking and market testing in the sense that the programme is not at a stage where a lot of projects have got to that point, so I would say we are on top of this, we have got a robust policy, and the NAO agreed with us, I believe, that this is an approach that will be better value for money than the one that prevailed before.

Q71 Mr Mitchell: Turning to local authorities, I cannot see how health authorities, to take the case examples on page 24 of the Report, case example four, the great success of Leeds, is paralleled by a much bigger set of case examples, five, examples of mess-ups and cock-ups and overcharging and general inadequacy. I cannot see that the small local authorities and health authorities, which are inexperienced in these matters, are going to be competent to deal with these powerfully articulated, very professionally managed firms which are used to it now.

Mr Kingman: We absolutely agree that that is a challenge and that procurement authorities around the public sector have not always had the skills that they ought to have done. What we have done is seek to put in place ways of supporting them through things like the Operational Task Force, standardised contracts, which I think help, and practical help and support through Partnerships UK.

Q72 Mr Mitchell: But how does a small local authority know the difference between a good and a bad client? How is it in a position to evaluate the terms it has been offered? Are we going to get a situation where they are trying to catch up running from behind?

Mr Stewart: I think the greatest challenge for any public body, and one of the prime causes of delays and cost increases, is the problems in setting the specification and actually defining the requirement they want. I think on the evaluation side things are relatively okay because, to be honest, they always have a financial adviser and the financial advisers have done this in many other cases before and on strict evaluation they get legal and financial advice which supports them, and so I do not think the evaluation is a problem. What I think is much more difficult is articulating and refining the requirement.

Q73 Mr Mitchell: Would it not be better if you had a Treasury team, a fire brigade, that went in and advised local authorities that are doing this?

Mr Kingman: We do, in the form of Partnerships UK.

Q74 Mr Mitchell: You are reviewing it when it comes in centrally, you do not send people out to advise them.

Mr Kingman: We do.

Mr Stewart: Partnerships UK had 50 to 60 people during the period that this Report covers and I think there were probably 200 projects in procurement, so there is a limit to the extent to which a central team can put people on the ground on these individual projects. Partnerships UK, as agreed with our advisory council, which is full of people from the public sector, the remit that we have agreed and criteria that we use to select projects is that we will work individually on large—

Q75 Mr Mitchell: That is a counsel of despair, is it not, you have not even set up a training scheme to tell people in the public sector how to handle these?

Mr Stewart: We have not but certainly the Treasury and other central bodies have set up training schemes so there is a training scheme run for the public sector

Q76 Mr Mitchell: Which is available to local authorities and health trusts?

Mr Stewart: It is. I would add that training can only take you so far. As people have pointed out, these are complex procurements and there is nothing like actual experience of negotiating these contracts, and just being told how to do it for two days or even a week is not really sufficient.

Q77 Mr Mitchell: It is a bit of a side issue but I can perhaps see the case, although I do not like it, for a building contract for a hospital or a school but I cannot see any case for a 30 or 35-year contract for

catering. That just puts an incumbent in an extremely powerful position of dominating the market, what is the incentive on them to improve matters?
Mr Kingman: As I mentioned earlier, we are rather carefully neutral. We are not in a position where we are positively advocating the use of—

Q78 Mr Mitchell: Who is doing it then?
Mr Kingman: There are situations, particularly where it is integral to the nature of the project, where it can work, but we would expect contracts of that kind to be subject to regular market testing. That is what our guidance says. That is to say that the incumbent can lose, as they have done in as I say 46% of those to date.

Q79 Mr Mitchell: Might a bidder for a PFI contract say, "We will build the hospital we also want the catering"?
Mr Kingman: That is correct.

Q80 Mr Mitchell: That is monstrous.
Mr Pocklington: Well, as we have said, this is purely a value for money decision as to whether or not to include soft services.

Q81 Mr Mitchell: It is blackmail; they build the kitchen and they have got the catering contracts.
Mr Pocklington: There may be cases where it is a sensible thing to do from a value for money perspective. As an example it might be the case if there is an aspect of the soft services that is integral to the design of the overall PFI project, so quality of flooring for example may affect cleaning costs.

Q82 Mr Mitchell: That is feeble, frankly. Let me move on to a point the Chairman raised, the number of bidders has come down, has it not, and we are in a situation now where some contracts only have two bidders. Is there any evidence of collusion? Firms are complaining about the cost of preparing a bid, it is so difficult for them some of them are even getting compensation for the cost of preparing a failed bid, which seems a real a tribute to British capitalism that it can get this out of it, but is there any evidence of collusion, that they say, "You have this bid and I will put in something that is a bit pathetic but I will have that bid"?
Mr Kingman: No, and bid-rigging of that kind would be very serious, indeed it would be criminal.

Q83 Mr Mitchell: If that was going on would you detect it?
Mr Kingman: I very much hope we would detect it and all the competition authorities would detect it.

Q84 Mr Mitchell: There is no likelihood you would, is there?
Mr Kingman: There is no guarantee that we always know what is happening, I agree. I would say on this point about are we getting very few bidders, if you take the *Building Schools for the Future* programme, if you take 26 projects, 24 of them had at least three bidders and the only two that did not were the non-PFI projects out of the 26.

Q85 Mr Mitchell: Okay, let me come back to the other point about the preferred bidder status, this seems to be a restriction of competition. Why do you want preferred bidder status, why not just open competition?
Mr Stewart: The answer to your question is actually now the preferred bidder appointments are much later. Under the competitive dialogue you run with two bidders for much longer and there is a requirement under the European procedure to sort out all the contractual terms before the appointment of a single bidder. In the past it was always a judgment as to when you go to a single bidder, the advantage of going to a single bidder being that you can concentrate your resources on one person rather than two. There has been a lot of pressure, I think it is fair to say, from the private sector to go down to a single bidder.

Q86 Mr Mitchell: I'll bet!
Mr Stewart: It comes back to the point of bid costs. One of the issues with competitive dialogue which the private sector is grappling with is the second placed bidder will spend a lot more money.

Q87 Mr Mitchell: But is it your intention that there should not be any later negotiations and that the local authority does not change its mind after it has got a preferred bidder and start redesigning the whole thing?
Mr Stewart: It is both our intention and a function of the new competitive dialogue process that that period should be much shorter, and we think that is a very desirable thing.

Q88 Mr Mitchell: How do you stop them fiddling around with it later?
Mr Stewart: In the end local authorities, as we discussed earlier, control their own process but we very strongly discourage them.

Q89 Mr Mitchell: The organisations that are mentioned in the Report to co-ordinate this process—4ps (whatever 4ps might be) Partnerships for Schools and Partnerships UK—what are these bodies and how do they help in the process, are they trade associations or what?
Mr Kingman: I will ask James to give a more thorough answer but if you take something like Partnerships for Schools, one of the reasons that we set that up was precisely that we were seeing a situation where we were having a lot of procuring authorities all trying their hand at doing the same thing, replicating the same process, and it seemed to us, particularly if we wanted to get tendering costs down and generally to get better value for money, what we needed to do was draw this together and have a more standardised process.
Mr Stewart: The answer is all these three bodies are slightly different. There are some bodies that sit in the centre—the OGC, obviously the Treasury PFU,

and Partnerships UK really support the central departments. There are private finance units which sit within each government department and the 4ps is funded by a top-level grant from DCLG and is sponsored by the Local Government Association and it is really the private finance unit for local authorities. I could go on.
Mr Mitchell: I shall be censored if you go on so thank you.
Chairman: Your last questioner is Mr Bacon

Q90 Mr Bacon: Mr Kingman, when we last met, you very kindly accept sent in a note which was taken from the PFI Signed Projects List which showed a total capital value of projects of something like £54.55 million, which we have reproduced in our 25th Report (HC 158) *PFI Debt Refinancing and the PFI equity market* update which was published a month or so ago, and in that note one of the things you said was: "Note, the PFI signed deals list records capital values not the debt amount likely to arise therefrom." What is your estimate of the debt amount likely to arise therefrom?
Mr Pocklington: I do not have that information to hand. We would have to get you a note on that.
Chairman: Within two weeks please.

Q91 Mr Bacon: Hang on a minute, you do not know how much debt is likely to arise from the PFI projects that you have signed? How can you plan, how can the Chancellor do a Budget if you are not able to advise him each year and in aggregate over a period of years going forward how much debt is likely to arise? This is to Mr Pocklington: how can you possibly not know?
Mr Pocklington: I think it is important to think about how PFI impacts on the public finances, which I think is fundamentally what is lying behind your question.

Q92 Mr Bacon: There is an annual unitary charge for each project and, correct me if I am wrong, but each project more or less has a unitary charge of a different amount and if you add them all up you get the total amount annually for one year of the unitary charge that has to be paid, and if you do that going forward you would get the total debt amount likely to arise therefrom, would you not—
Mr Pocklington: I apologise—

Q93 Mr Bacon: —would you not?
Mr Pocklington: I apologise, Mr Bacon, I misunderstood your original question.

Q94 Mr Bacon: Can I be clear that what I have just said is correct. I take the annual unitary charge for all the PFI projects, I add them up, I get the total amount in one year of annual unitary charges in total which I must pay; is that correct? Is that correct, yes or no?
Mr Pocklington: That would be the total amount the public sector is paying.[2]

[2] Ev 13-14

Q95 Mr Bacon: In one year?
Mr Pocklington: In one year in unitary charges.

Q96 Mr Bacon: Yes, now if I add them all up going forward, in each case for the life of the contract, add them all up over the years, then I would get, would I not, the debt amount likely to arise therefrom in total?
Mr Pocklington: You would get the total amount the public sector has paid through unitary charges.

Q97 Mr Bacon: Not has paid, I am talking about the future.
Mr Pocklington: Sorry, it is projected to pay.

Q98 Mr Bacon: Yes, and you must know what that number is otherwise you could not plan, you could not budget, you could not do anything, so you must know that number, must you not?
Mr Pocklington: Yes.

Q99 Mr Bacon: What is it?
Mr Pocklington: We publish the unitary charge data for the forthcoming 26 years on an annual basis at Pre-Budget Reports and Budget Reports.

Q100 Mr Bacon: And what is it?
Mr Pocklington: I do not have—

Q101 Mr Bacon: I have been trying for several years to get to the bottom of how big is PFI, and that is really what lies behind my question, Mr Pocklington, I am trying to get to the bottom of the question how big is PFI, and it seems to be quite difficult to get an accurate answer. I have been told by various people, including by the National Audit Office, answers such as, "Well, really they do not know," which is I presume why it was, and it was referred to, Mr Kingman, in your answer to my question 150, that there has been a "detailed and resource-intensive exercise covering more than 500 projects that have been signed over 15 years", you make it sound like it was big of you to do this resource-intensive exercise to find out how much of my and others' constituents' money you are spending. So perhaps the NAO when they told me casually that they were not actually sure that you knew were correct, but you must have some notion of what is the likely amount of debt to arise therefrom going forward?
Mr Pocklington: The total stock of PFI projects has a capital value of approximately—

Q102 Mr Bacon: We have been through that. £54.55 billion, although if you look on your website—and I am going to come on to your website in a minute—it is actually now £58.067 when I printed that off this afternoon, so it has gone up by about £4 billion since you sent your note in. On page F16 the note says it is £54.55 billion in the Report we published on 15 May but presumably the website is accurate, is it?
Mr Pocklington: The Treasury website contains our best available information on the capital funding—

Q103 Mr Bacon: Hang on, when you say Treasury website, I am talking about the Partnerships UK website where it gives present PFI projects data. Is that what you are referring to as well, is it?
Mr Pocklington: There are different databases. What I am referring to is the Treasury website which contains all PFI projects and is the basis of the evidence that Mr Kingman sent to this Committee.

Q104 Mr Bacon: Partnerships UK comes under the Treasury, does it not? Yes? No?
Mr Pocklington: Partnerships UK—
Mr Stewart: It is a joint venture project. The Treasury has a 49% stake in Partnerships UK so it is not—

Q105 Mr Bacon: Nonetheless, your number is £58.067 billion. Presumably it is more up-to-date, it includes the more recently signed deals?
Mr Stewart: There are some differences now between our database and the Treasury database because ours contains some historic projects which the Treasury recently took off their database.

Q106 Mr Bacon: I want to come on to the website but actually, Mr Pocklington, you were apparently trying—I am not sure you were trying to, that is unfair—or you were missing my point which is that I am not after the capital value (we have already discussed capital value, that was in my first question) my question is this bit underneath about PFI signed deals recording capital values and not the debt amount likely to arise therefrom. My first question was what is the debt amount likely to arise therefrom and I have been waiting for an answer for the last few minutes.
Mr Pocklington: The projected unitary charge payment for 2007-08 is £7.3 billion.

Q107 Mr Bacon: And over the life, because we know in the case of each PFI project how long it is supposed to last because we have a term of it, if you add them all up, what is the likely amount of debt to arise therefrom?
Mr Pocklington: Table C19 from the Budget document includes our latest estimate for the years 2006-07 to 2033-32 on an annual basis.

Q108 Mr Bacon: If you add it all up what do you get?
Mr Pocklington: We have not published a number and I am afraid I am not able to add them up here.

Q109 Mr Bacon: Well, it is £7 billion this year, roughly £7 billion next year.
Mr Pocklington: It is £7.8 million next year, £8.2 million, £8.5 million—

Q110 Mr Bacon: Just in the next four or five years it is £7 or £8 billion a year so for the next five years it is £40 billion; is that right?
Mr Pocklington: More or less, approximately.

Q111 Mr Bacon: Mr Pocklington, can you just give me, because funnily enough I have got a calculator, the numbers please?
Mr Pocklington: From 2007-08?

Q112 Mr Bacon: Yes, read them out. I will put them straight into my calculator and this will save us time.
Mr Pocklington: 7.3, 7.8, 8.2, 8.5, 8.6, 8.7, 8.8.

Q113 Mr Bacon: I am already at £57 billion, by the way! Keep going.
Mr Pocklington: 8.8, 8.8, 8.9, 8.2, 5.8, 5.8.
Mr Bacon: Whoops!
Chairman: A few billion either way will not matter.

Q114 Mr Bacon: Keep going.
Mr Pocklington: 5.9, 5.5, 5.4, 5.4, 5.4, 5.2, 5.0, 4.8.[3]—
Chairman: All right.

Q115 Mr Bacon: No, I want the whole lot, keep going.
Mr Pocklington: 4.5, 4.2, 3.8, 3.4.

Q116 Mr Bacon: That is the whole lot, is it?
Mr Pocklington: Yes.

Q117 Mr Bacon: Going up to which year?
Mr Pocklington: 2031-32.

Q118 Mr Bacon: And is that the maximum extent to which there are known contracts, so to speak?
Mr Pocklington: That is the maximum that we collect through our biannual process of collecting data.

Q119 Mr Bacon: How much further beyond that does it actually go?
Mr Pocklington: It will depend on the length of contracts, that will include the vast majority of contracts.

Q120 Mr Bacon: That comes to £157.9 billion. Is that then a rough proxy for the answer to my first question, Mr Stewart?
Mr Stewart: I think that is the liabilities accruing under PFI.

Q121 Mr Bacon: That is what I am interested in.
Mr Stewart: That is not equivalent to the debt.

Q122 Mr Bacon: Right, so the debt is something different?
Mr Stewart: The debt relates to the capital element so the unitary charges include payments for soft services.

Q123 Mr Bacon: You brilliantly bring me on to my next question because presumably therefore, to take an example on your website, the MoD building is £439 million capital value in there. Last time I looked last year it said £300 million and something, so quite how it has gone up I do not know, but, anyway, the National Audit Office Report said £746

[3] *Note by witness*: The figures quoted here were taken from table C19 of the 2007 Budget document. HM Treasury provided the Committee with a copy of this table in a follow up note to this hearing (Ev 13 & 15).

million was the value of the contract and the difference which is quite significance is accounted for --- sorry I am getting mixed up, it is not £458 million it is £370 million, the difference between the £439 million on your website which says capital value and the £746 million referred to in the National Audit Office Report where it says the price of the 30-year deal is £746.1 million, that difference of £448 million is accounted for by what, just the soft services—I am sorry it is £307 million, the difference of £307 million is accounted for by what?

Mr Stewart: You have the advantage of figures which I am not familiar with. I am afraid I do not know all the figures in our database. I can give you a note on that if you would like.

Q124 Mr Bacon: It puzzles me that here we have the National Audit Office itself saying that the value of this deal—and, Sir John, you will remember the MoD building very well, you did a big Report on it—and it was £746 million, the number stuck in my head very clearly, and yet your website says that the value of this deal at least the capital value (you wrote down the words capital value) is £439 million.

Mr Stewart: I suspect the difference between the two figures is the lower figure is the capital and the higher figure is the unitary charge, but I do not know, I am guessing.

Q125 Mr Bacon: £746 million is that upon which the unitary charge is based, presumably, is it not?

Mr Stewart: I am sorry, I am just not familiar with this project.

Q126 Mr Bacon: I am running out of time but I would just like to ask one other question, if I may very briefly, and that relates to the Libra project. On your website it says £38.9 million, that is the capital value of that project. We knew when the National Audit Office published its Report on 29 January 2003 that the Government had spent £390 million on it. Last June Alex Allan told us that it has now gone up by another £98 million so it is now £487 million. The difference between £487 million and what you have got on there of £38.9, that is my £448 million. Where did that £448 million go?

Mr Stewart: Again I am afraid I am not familiar with that project. What I would just point out is that our database was something that we created three to four years ago. We rely on information received by departments and local authorities. We rely on them providing that voluntarily. We are not required to forensically examine that information. We provide it as the best information we can produce and it is helpful to both public sector and private sector alike. We do not give a 100% guarantee that the data is all correct. It has a different nature to the data that is supplied for the Red Book. It is designed to be helpful to the market rather than, as I said, we do not go to the nth degree to get it 100% accurate.

Mr Kingman: I do not want to interrupt but I think I may be able to answer your question on the MoD building, if that would be useful. We covered this in the letter that I sent to the Chairman following the last hearing and there were two figures, one was £746 million and one was £345 million. Both those figures are correct. The £345 million is the capital value and the £746 million is the net present value of the unitary charge payments.

Q127 Mr Bacon: Yes, but the unitary charge payments over the life of the project reflect the cost of servicing the PFI in total, do they not, including the cost of constructing the thing.

Mr Stewart: And providing services so that the building is available over the lifetime of the contract with whatever services are in the contract, so it is not right to equate that simply with borrowing.

Q128 Mr Bacon: Of course the cost, as we know, is more like £2.3 billion the MoD will actually pay. It was £2.5 billion, it seems to have come down to £2.3 billion now, so it is interesting the capital value is so much lower. Is it possible, Mr Kingman, you will know roughly what my question is from the transcript about this total debt therefrom. I would rather rely on the Treasury website than the Partnerships UK one, if you can send us a note giving us a more accurate rendition of my rather quickly calculated number and then explain --- what was the date to?

Mr Pocklington: 2031-32.

Q129 Mr Bacon: Is it possible you could first do it up to 2031 as far as it goes and then explain in total how much there is beyond that accounted for by whatever contracts there are that for some reason or other run longer than that?

Mr Kingman: We will certainly do our best. I am not sure there is anything very useful we will be able to say about the period beyond 2031-32.

Mr Bacon: I am looking for a number that probably is in the region of £150 billion to £160 billion, by the sound of it, but I would like a more accurate one and some assessment from you of where you think it might be going after on that, so if you add the two together you would get a total public sector liability.

Q130 Chairman: Under your own rules you will agree to do that within two weeks. I think that concludes our hearing. These are poor Reports and given that we are in front of supposedly the brightest minds in the Civil Service we have not found your performance very reassuring. We last looked at this four years ago and found that PFI deals were slow and cumbersome and as such posed a threat to taxpayers' money. Since then we are seeing departments persistently underestimating the cost of launching PFI deals, adviser costs alone have soared to 75% more than expected, a third of all deals went through major changes with only one bidder left at the table. We think there has been a lot of foot-dragging on the part of departments and, as we have found out today and seen in this Report, PFI deals are lasting about three years, wasting, as I say, tens of millions of pounds. So we will issue another Report and, Mr Kingman, when we return to this again in four years' time we hope to see a lot more progress because PFI was supposed to be the glad, confident morning of contracting services in the public sector. It may be a good idea, and we are not competent to make policy on this issue, but it seems there have been enormous wasted opportunities and we the taxpayer are paying the price. You may make a final comment if you wish.

Mr Kingman: I would only add, Chairman, that we too hope and indeed expect, as and when we appear in front of you next time, to be able to show that there has been more progress.

Chairman: Thank you very much.

Supplementary memorandum submitted by HM Treasury

Question 48 (Dr John Pugh): *St John's Bootle Benchmarking exercise*

At the hearing you also requested a note setting out some details on the reason why St John's House Bootle PFI Benchmarking exercise took 25 months.

In fact, this is addressed by the NAO in paragraph 2.13 of their Report, which sets out that: "In the case of St John's House, Bootle, the benchmarking took 25 months as the public sector rejected the proposed 16 per cent increase in the price of services as this would have exceeded the cap on the services element portion of the quarterly Unitary Service Charge."

In addition, as table 16 indicated there was some difficulty in agreeing the comparative data for the benchmarking exercise, and this may have also contributed to the timescale.

It should be noted that the proposed 16% price increase was successfully opposed by the public sector and the final outcome was that there was no change in the price and no change to the services. As table 11 (p18) shows, the NAO's assessment of this outcome was that it was likely to have achieved value for money.

Question 94 (Mr Richard Bacon): *Projection for the aggregate future cash outlays expected under Private Finance Initiative contracts*

You asked us to break this down into projections for the total of expected annual payments for PFI deals:

- — up until 2031–32; and
- — beyond 2031–32.

Expected Payments Up Until 2031–32

The aggregate amount of cash to be paid out under the unitary charge payable on all signed PFI deals (subject to benchmarking or market testing of the relevant portions of the contract) covering the period up until 2031–32 is published in the Budget document and Pre-Budget Report each year. The relevant table from this year's Budget is Table C19:

Table C19

ESTIMATED PAYMENTS UNDER PFI CONTRACTS—MARCH 2007 (SIGNED DEALS)[1]

	£ billion Projections		
2006–07	6.9	2019–20	5.8
2007–08	7.3	2020–21	5.9
2008–09	7.8	2021–22	5.5
2009–10	8.2	2022–23	5.4
2010–11	8.5	2023–24	5.4
2011–12	8.6	2024–25	5.4
2012–13	8.7	2025–26	5.2
2013–14	8.8	2026–27	5.0
2014–15	8.8	2027–28	4.8
2015–16	8.8	2028–29	4.5
2016–17	8.9	2029–30	4.2
2017–18	8.2	2030–31	3.8
2018–19	5.8	2031–32	3.4

[1] The figures between 2006–07 and 2017–18 include estimated payments for the LUL PPP PFI contract. These contracts contain periodic reviews every 7.5 years and therefore the service payments are not fixed after 2009–10.

These projections are in nominal terms and so incorporate the inflation assumptions built into contracts.

Expected Payments After 2031–32

The projected aggregate PFI payments for 2032–33 and 2033–34 are £3.0 billion and £2.7 billion respectively. HM Treasury does not hold data for the period after 2033–34, and so does not make projections beyond that date.

Total Future PFI Payments

The numbers presented here are the projected aggregate future cashflows under signed deals. The figures are in nominal terms, not today's money, and thus adding them together does not produce a meaningful figure. For the avoidance of doubt it would not be correct to refer to these projections as additional to Public Sector Net Debt (PSND), not least since many of these liabilities (where the relevant project is on the public sector's balance sheet) are already included within PSND.

Exchange of correspondence between the Committee and John Kingman

I am writing to confirm the request made by Mr Bacon in his telephone conversation with you last Thursday (19.07.07).

At the Committee's hearing on 20 June, Mr Bacon requested details of the projection for the aggregate future cash outlays expected under PFI contracts up until 2031–32 (Qq 99–122). He also set out his request for a total in question 129:

> Q129 Mr Bacon: Is it possible you could first do it up to 2031 as far as it goes and then explain in total how much there is beyond that accounted for by whatever contracts there are that for some reason or other run longer than that?
>
> Mr Kingman: We will certainly do our best. I am not sure there is anything very useful we will be able to say about the period beyond 2031–32.
>
> Mr Bacon: I am looking for a number that probably is in the region of £150 billion to £160 billion, by the sound of it, but I would like a more accurate one and some assessment from you of where you think it might be going after on that, so if you add the two together you would get a total public sector liability.

The supplementary note provided by you on 3 July provides the figures year-by-year up to 2031–32, but does not give a total as requested.

Mr Bacon appreciates that any total would be spread over a 24 year period and would thus not have the same economic value as an identical amount paid today. Nonetheless, he has repeated his original request for such a total: he would be happy for this to be accompanied by a note thoroughly explaining the differences between a total spread out over 24 years and a total in today's money.

26 July 2007

Your clerk's letter of 26 July asked for an aggregation of the future nominal cash outlays expected under Private Finance Initiative (PFI) contracts up until 2031–32.

I should first apologise that, due to a problem in one of the underlying spreadsheets provided to us by Departments, a slightly incorrect version of the annual unitary charge payments table was provided to you in my 3 July letter. A corrected version is attached to this letter. I apologise to the Committee for this error.

You have asked us to provide you with a total of these figures. The total, if one were to add together these future and non-comparable figures without applying any appropriate adjustments, would be £170.8 billion. However, I must emphasise, as I already have to the Committee and to Mr Bacon, that this number has no meaning. To add together a figure in today's money to a figure in the money of 2030, without making any adjustment for the changing value of money over time, produces a nonsensical number. It is rather as if we were adding a figure in £ to one in $, without converting the currencies, and ending up with one that is not denominated in any currency at all. I am obviously uncomfortable providing the Committee with a figure which is meaningless and I would not want the Committee to be in any way misled about this.

A more meaningful exercise would be to take the stream of future payments set out in the table and to aggregate them as a net present value. If one were to do this one would end up with total future payments under the PFI measured in today's money which aggregate to £91 billion. The discounting methodology applies the Green Book rate of 3.5% to account for time preference and a discount of 2.8% to account for inflation. These two elements are compounded to give an overall discount rate of 6.4%. The inflation figure of 2.8% is HM Treasury's projection for RPI inflation consistent with CPI inflation remaining at its 2% target.

I should emphasise, as I explained in my previous letter, that it would not be correct to regard either of these figures as additional to Public Sector Net Debt (PSND).

This is for two reasons. First, many of the liabilities (where the debt portion of the relevant project is on the public sector's balance sheet) are already included within PSND. Second, unitary charges under PFI contracts include an element of payment for use of a school or hospital, but also include payment for the services—cleaning, catering and maintenance—associated with running that asset. These service payments would score as current expenditure in any circumstance. (To add PFI unitary payments together and say this is to be added to PSND would be akin to adding up the electricity, gas, cleaning, and food bills for a family home over the next 30 years and saying that this amount is part of the mortgage debt on the house.)

Table C19

ESTIMATED PAYMENTS UNDER PFI CONTRACTS—MARCH 2007 (SIGNED DEALS)[1]

	£ billion Projections		
2006–07	6.8	2019–20	6.3
2007–08	7.3	2020–21	6.4
2008–09	7.8	2021–22	6.0
2009–10	8.2	2022–23	6.0
2010–11	8.5	2023–24	6.0
2011–12	8.6	2024–25	6.0
2012–13	8.7	2025–26	5.9
2013–14	8.8	2026–27	5.6
2014–15	8.8	2027–28	5.4
2015–16	8.9	2028–29	5.1
2016–17	9.0	2029–30	4.8
2017–18	8.4	2030–31	4.3
2018–19	6.2	2031–32	3.8

[1] The figures between 2006–07 and 2017–18 include estimated payments for the LUL PPP PFI contract. These contracts contains periodic reviews every 7.5 years and therefore the service payments are not fixed after 2009–10.

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