

Report to: EXECUTIVE CABINET

Date: 26 August 2020

Executive Member: Councillor Oliver Ryan - Executive Member (Finance and Economic Growth).

Reporting Officer: Jayne Traverse, Director of Growth

Subject: **PYRAMID SCHOOLS PFI CONTRACT PARENT COMPANY GUARANTEE & COLLATERAL WARRANTIES**

Report Summary: To seek approval to replace the Parent Company Guarantee (Parent Company Guarantee) and associated Collateral Warranties (Collateral Warranty) on the Pyramid Schools PFI contract following the collapse of Interserve PLC, provider of the original Parent Company Guarantee's & Collateral Warranty's

Recommendations: That the EXECUTIVE CABINET are RECOMMENDED to authorise the Assistant Director of Strategic Property and Head of Legal Services to introduce a suitable replacement Parent Company Guarantee and Collateral Warranties for the Pyramid Schools PFI contract on behalf on the Council.

(i) This variation to include the Council providing its consent under Clause 21.2 of the Project Agreement to:

- a deed of variation of the Facilities Management Subcontract (FM Subcontract) with the FM Subcontractor (Interserve Facilities Management Limited);
- a deed of variation of the Fabric Replacement Subcontract (FR Subcontract) with the FR Contractor (Interserve Construction Limited);
- a FM Subcontract Direct Agreement with the FM Subcontractor, Interserve Group Limited (the Replacement Guarantor) and Bank of Scotland PLC;
- a FR Subcontract Direct Agreement with the FR Contractor, the Replacement Guarantor and the Bank of Scotland PLC;
- a parent company guarantee with the Replacement Guarantor in respect of the FM Subcontract; and
- a parent company guarantee with the Replacement Guarantor in respect of the FR Subcontract.

(ii) That the Council enters into:

- the replacement Collateral Warranties with the Special Purpose Vehicle, the Replacement Guarantor and the Bank of Scotland PLC for the FM Sub-contract
- the replacement Collateral Warranties with the Special Purpose Vehicle, the Replacement Guarantor and the Bank of Scotland PLC for the FR Sub-contract

Corporate Plan: The change maintains and supports a number of themes contained in the Corporate Plan with a particular emphasis on Theme 2 – Aspirations and Hope

Policy Implications:

In line with corporate policy

**Financial Implications:
(Authorised by the statutory
Section 151 Officer & Chief
Finance Officer)**

The Council is responsible for the payment of the unitary charge to Pyramid Schools (Tameside) Ltd, the special purpose vehicle (Special Purpose Vehicle) that was established to design, build, finance and operate three schools in Hattersley.

The annual costs amount to £3.328m and are funded from PFI credits (in the form of an annual grant from the government) and contributions from the schools paid for from their annual delegated budgets.

Whilst the majority of the risk for delivery of the PFI services rests with the Special Purpose Vehicle, the Council gains additional assurance that the company is under written by its parent company if the Special Purpose Vehicle, or any of its subcontractors, is unable to deliver the services under the terms of the contract. Currently the parent company guarantees have lapsed due to the insolvency of the original parent company. This removes the additional level of assurance to the Council. The entering into a new parent company guarantee with Interserve Group Limited, will provide some additional assurance to the Council if the Special Purpose Vehicle were to enter any financial difficulties or were unable to deliver its services.

The new arrangements are a replacement of the previous arrangements are there are no direct financial costs to the schools or the Council in entering into these arrangements, although they do act to reduce the total level of residual risk to the Council.

**Legal Implications:
(Authorised by the Borough
Solicitor)**

Put simply this report is intended to replace a guarantor who has gone into liquidation and put a marker in the ground around risks to ensure firstly that necessary due diligence undertaken and to ensure contract being closely monitored.

The insolvency of the original guarantor is an event which would entitle the Council to terminate the contract. By signing the amended documentation and confirming that the Council will not treat the insolvency as a breach of the contract, the Council has to be comfortable that the revised position is satisfactory; whether that means that the replacement guarantor is as strong as the original guarantor, or less, but better than no guarantor, is a matter which the Council must consider and accept.

The information available suggests that the replacement guarantor is not as strong as the original guarantor and this report suggests that "a guarantor" is better than "no guarantor". Whilst that might on the face of it appear to be acceptable, the Council must ensure that it does not become complacent in believing that there is a reliable guarantor in place in the event of default, or breach by the main contracting party and ensure that it rigorously monitors the contractual arrangements.

Risk Management:

The risks associated with this report are set out in section 6.

Background Information:

The background papers relating to this report can be inspected by contacting Paul Smith (Assistant Director Strategic Property)



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1. INTRODUCTION

- 1.1 As part of the procurement process for the Hattersley Schools PFI Project, that concluded in 2002, the financial standing of bidders had to be demonstrated. Pyramid Schools (Tameside) Limited (the Special Purpose Vehicle), the special purpose vehicle set up to deliver the Project by the winning consortium, was a new legal entity and as such was required by the Council to support its obligations and commitments for the Project by the provision of a variety of Parent Company Guarantees and Collateral Warranties. The Collateral Warranties were Conditions Precedent under the Project Agreement for the Project.
- 1.2 Additionally, it was a requirement (Condition Precedent) within the Credit Agreement with the Bank of Scotland plc, the senior debt provider for the Project that the Parent Company Guarantees and Collateral Warranties were entered into. The Parent Company Guarantees and Collateral Warranties had to be executed before the Special Purpose Vehicle could drawdown any of the senior debt funding from Bank of Scotland.

The required Parent Company Guarantees were:

- Build Contract Parent Company Guarantee
- FM Sub-contract Parent Company Guarantee
- FR Sub-contract Parent Company Guarantee

The required Collateral Warranties were:

- Build Contract Collateral Warranty
- FM Sub-contract Collateral Warranty
- FR Sub-contract Collateral Warranty

- 1.3 The above Parent Company Guarantee & Collateral Warranty requirements were satisfactorily provided enabling the 3 Pyramid PFI schools to be constructed and operated. The schools within this contract are: Alder Community High School, Arundale Primary and Nursery School and Pinfold Primary and Nursery.
- 1.4 On 15 March 2019 Interserve plc, the original Guarantor and parent company of Interserve (Facilities Management) Limited and Interserve Construction Limited went into administration and these two companies were sold to Interserve Group Limited (Company No 11830440), a newly incorporated private company controlled by its lenders.
- 1.5 As the original Parent Company Guarantees and Collateral Warranties are no longer effective due to the demise of Interserve plc, a replacement guarantor is now required.

2. PURPOSE OF PARENT COMPANY GURANTEES AND COLLATERAL WARRANTIES

- 2.1 The purpose of Parent Company Guarantees and Collateral Warranties are to provide assurance, to both the Council and Funder (Bank of Scotland), that behind the two principle sub-contractors was a strong Group of established and sustainable businesses with good financial standing and to provide for guarantees that there was an entity that would be ultimately responsible for the Project.
- 2.2 If the relevant sub-contractor failed to perform any of the terms, conditions, obligations and agreements under its sub-contract, then the Guarantor (Interserve plc) agreed to perform and fulfil, in place of the relevant sub-contractor, each and every obligation or warranty given in the sub-contract. The Guarantor was liable to the Special Purpose Vehicle, under the Parent Company Guarantees, for any and all losses, damages, expenses, liabilities, claims, costs or proceedings which the Special Purpose Vehicle suffered or incurred by

reason of any such failure or breach, and likewise under the Collateral Warranties to the Council.

3. OVERVIEW OF ORIGINAL PARENT COMPANY GUARANTEES AND COLATERAL WARRANTIES

Parent Company Guarantees

- 3.1 In all cases the Parent Company Guarantees were given by Interserve plc (Company No 88456) in favour of the Special Purpose Vehicle. Pursuant to the Parent Company Guarantees, Interserve plc respectively agreed to guarantee all of the obligations of:
- the Build Contractor (Interserve Project Services Limited (Company No 303359)) under the Build Contract;
 - FM Sub-Contractor (Interserve (Facilities Management) Limited (Company No 3253304)) under the FM Sub-Contract; and
 - FR Sub-contractor (Interserve Project Services Limited (Company No 303359)).

The Guarantor's liability under the relevant Parent Company Guarantee was limited to the respective liability of the relevant sub-contractor under its sub-contract, together with any costs reasonably and properly incurred (including legal fees) of the Special Purpose Vehicle in enforcing the Parent Company Guarantee.

Collateral Warranties

- 3.2 In addition to the Parent Company Guarantees, Collateral Warranties were entered into, directly with the Council, providing it with a direct guarantee of performance and delivery. The Collateral Warranties were entered into between:
- The Council, the Build Contractor (Interserve Project Services Limited now called Interserve Construction Limited), Interserve plc and the Special Purpose Vehicle providing a warranty granting certain direct contractual rights to the Council in respect of the Build Contract;
 - The Council, the FR Sub-Contractor (Interserve Project Services Limited now called Interserve Construction Limited), Interserve plc and the Special Purpose Vehicle providing a warranty granting certain direct contractual rights to the Council in respect of the FR Sub-Contract;
 - The Council, the FM Sub-Contractor (Interserve (Facilities Management) Limited, Interserve plc and the Special Purpose Vehicle providing a warranty granting certain direct contractual rights to the Council in respect of the FM Sub-contract.

4. PROPOSED REPLACEMENT PARENT COMPANY GURANTEES AND COLLATERAL WARRANTIES

- 4.1 Interserve Group Limited, the parent company of both the FM Subcontractor and the FR Subcontractor, has agreed to:
- guarantee all of the obligations of the FM Sub-contractor under the FM Sub-Contract; and
 - guarantee all of the obligations of the FR Sub-contractor under the FR Sub-Contract.

Accordingly, Interserve Group Limited (the Replacement Guarantor) will provide both the guarantees under the Parent Company Guarantees to the Special Purpose Vehicle and to the Council under the Collateral Warranties, in respect of the FM and FR Sub-contracts, the obligations under the Build Contract having been completed. Interserve Group Limited a newly incorporated private company (February 2019) and controlled by its lenders. As such this new company has not yet published an annual set of accounts.

Required Consent

4.2 The Special Purpose Vehicle has requested that the Council provides its consent under Clause 21.2 (b) of the Project Agreement to:

- a deed of variation of the FM Subcontract with the FM Subcontractor for the purposes of varying the FM Subcontract in order to make certain amendments to reflect arrangements relating to the acceptance of the Replacement Guarantor and certain related information and other requirements;
- a deed of variation of the FR Subcontract with the FR Contractor for the purposes of varying the FR Subcontract in order to make certain amendments to reflect arrangements relating to the acceptance of the Replacement Guarantor and certain related information and other requirements;
- a FM Subcontract Direct Agreement with the FM Subcontractor, the Replacement Guarantor and Bank of Scotland PLC;
- a FR Subcontract Direct Agreement with the FR Contractor, the Replacement Guarantor and the Bank of Scotland PLC;
- a parent company guarantee with the Replacement Guarantor in respect of the FM Subcontract; and
- a parent company guarantee with the Replacement Guarantor in respect of the FR Subcontract.

For execution

4.3 The Special Purpose Vehicle has requested that the Council enters into:

- the replacement Collateral Warranties with the Special Purpose Vehicle, the Replacement Guarantor and the Bank of Scotland PLC for the FM Sub-contract
- the replacement Collateral Warranties with the Special Purpose Vehicle, the Replacement Guarantor and the Bank of Scotland PLC for the FR Sub-contract

Note: That the Council notes the entering into of the Novation Agreement in respect of the Interface Agreement to include the Replacement Guarantor.

5. COST

5.1 There should be no additional cost other than using available internal resources.

6. RISK

6.1 Currently there is no entity guaranteeing the obligations and performance of the relevant FM and FR Sub-contractors to the Council. Therefore, by consenting to, or as the case maybe, entering into the replacement Collateral Warranties, the Council's position will be improved.

6.2 The only notable risk is the financial standing of the Replacement Guarantor, Interserve Group Limited, but as noted in the paragraph above their guarantee may be considered better than the current position which is no guarantee. This will continue to be regularly monitored and reviewed as part of the ongoing contract management arrangements.

7. OPTIONS

7.1 No other options are being considered

8. RECOMMENDATIONS

8.1 As set out at the front of the report