

THE ADVISORY COUNCIL OF PARTNERSHIPS UK

ANNUAL REPORT FOR 2001

1. Introduction

In June 2000 HM Treasury established Partnerships UK plc (“PUK”) as the successor body to the Treasury Taskforce. Its remit is to build upon the success of the Taskforce and provide a permanent and sustainable centre of expertise to continue the work of developing and expanding the Government’s PPP and PFI programmes. In February 2001 HM Treasury sold 51% of its stake in Partnerships UK to the private sector, and also sold a further 4.4% of its remaining shareholding to the Scottish Ministers. This exercise resulted in Partnerships UK becoming a Public Private Partnership in its own right, with a clear public sector mission, but operating with a majority of private sector shareholders.

As part of this process Treasury Ministers established an Advisory Council for Partnerships UK to ensure that Partnerships UK’s fulfilled its public sector mission. As Chairman of the Council, and having consulted my fellow Council Members, I am pleased to submit to Treasury Ministers and the Scottish Minister for Finance the first Annual Report of the Council’s activities for 2001.

2. Membership

The Council comprises representatives of Government Departments, the Devolved Administrations, Local Authorities and other public bodies that are amongst Partnerships UK’s most significant clients. Members are selected by HM Treasury to serve for unspecified terms. The membership is exclusively drawn from the public sector and I am supported by a small team of officials from the Treasury and Partnerships UK in my role as Chairman. There have been two retirements from the Council during the year and a small number of changes due to personnel movements within the public sector. Annex A to this Report lists the members of the Council that have served during the year.

3. Meetings

The Council has met on three occasions in 2001, in February, May and November. I am very pleased that Derek Higgs, the Chairman of Partnerships UK, and his executive team have attended all of these

meetings, and that the non-executive directors of Partnerships UK took the opportunity to meet the Council after the May meeting.

4. Terms Of Reference

The first item of business for the Council was to establish its terms of reference which it discussed at its February and May meetings. The agreed Terms of Reference were published in June 2001.

The Council does not have executive authority over Partnerships UK, but the Company's Articles of Association set out the legal authority under which the Advisory Council acts. In particular the Directors of the Company must have regard to the conclusions of the Advisory Council in formulating Partnerships UK's business plans.

Having considered the wishes of Treasury Ministers and Scottish Ministers, the Council agreed that its primary role will be to review the scope of Partnerships UK's public sector mission and the manner in which it is carried out. In undertaking this role, the Advisory Council will:

- represent generally the interests of the public sector in its dealings with PUK;
- act as a forum for discussing any concerns of the public sector in its dealings with PUK;
- review the ongoing business activities of PUK and in particular the types of PPP projects in which PUK is engaging, including sector coverage, geographical coverage and spread of activity across central and local government;
- review new business initiatives of PUK; and
- review the methodology and criteria used for selecting projects.

The published Terms of Reference set out this role, and summarise the aims and objectives of Partnerships UK, together with the working procedures by which the Council will operate. The full Terms of Reference are contained at Annex B.

5. Council Business during 2001

Throughout the year Partnership's UK's executive team has provided the Council with information about the work of the Company, and has attended Council meetings to provide briefing and answer the Council's questions. This has allowed the Council to familiarise itself with Partnerships UK personnel and the business generally. The Council has also been provided with the opportunity to consider the Annual Accounts and attend Partnerships UK's Annual General Meeting.

The Council has considered a wide range of issues relating to Partnerships UK and its business during the year. These included

consideration of the special issues which apply to the work of PUK for the Devolved Administrations in Scotland, Wales and Northern Ireland and discussion of the roles of the Office of Government Commerce and Partnerships UK in their joint responsibility for implementing the Government's PPP and PFI initiatives.

Specific items of business which the Council would like to highlight in this Annual Report are:

(a) PUK's Business Development and Growth

The Council was able to monitor PUK's growth during 2001, both in terms of projects undertaken, and the resources available within the Company.

At the May 2001 Council meeting PUK reported that it had concluded 17 Framework Agreements with public sector bodies, as part of the capital raising exercise in February. Under these PUK could provide a wide range of support to the public sector. This included an agreement with HM Treasury under which PUK provided, amongst other things, a help-line service, free of charge, to the entire public sector. The Council welcomed the continued provision of such free support to the public sector.

At the November 2001 Council meeting PUK reported that it had 13 Development Partnerships in operation with a wide range of public bodies, covering projects throughout the United Kingdom. PUK had a good sectoral spread, with projects in the health, defence, education, environment and transport sectors. The Council and PUK agreed that pursuing opportunities in the housing, waste and urban regeneration PPP markets would be priorities in 2002.

Throughout the year PUK provided strategic trouble-shooting and policy advice to central and local government. PUK's Science and Technology Unit published guidance for the public sector, at the request of HM Treasury, on joint venture companies, and took forward work on developing the Baker Report recommendations, and the Wider Markets Initiative.

(b) The Adoption of Selection Criteria for PUK

At the request of PUK, the Council considered the criteria which PUK should apply when deciding whether to work with a public body on a particular project, either under a development partnership agreement, or more generally under a support agreement. The Treasury Taskforce had used such criteria, and the Council agreed that in order to fulfil its public sector mission, PUK needed to apply a number of principles when considering business opportunities. The Board of PUK confirmed to the

Council that it would only undertake work for the public sector. That being the case the Council agreed with PUK that it should work on projects which met one of the primary project criteria of being large, complex, small and replicable, innovative or politically sensitive. In addition, PUK should consider the geographical and sector spread of its projects. PUK should also evaluate the nature of the public body seeking its help, and the need for the Company's investment criteria to be fulfilled in selecting projects. Full details of these criteria are set down in the Selection Criteria published on PUK's website, and contained at Annex C to this Report.

(c) Codes of Practice

The Council agreed with PUK's executive team that guidance should be produced which would set out how PUK would operate as a PPP in relation to its shareholders, its employees and its public sector clients. The first piece of guidance, a Code of Practice on PUK's relations with its shareholders was considered by the Council at its May meeting, and following consultation with appropriate UK audit bodies, the finalised Code was published on PUK's website in October 2001. A copy is attached at Annex D. The Council believes such Codes are important to the delivery of PUK's public sector mission, and further Codes will be finalised during 2002.

(d) Pricing Policy

At the November 2001 meeting the Council received a presentation from James Stewart, the Chief Executive of PUK, on the Company's pricing policy. The presentation did not consider individual projects, but concentrated on the methodology behind the pricing of the various products offered by PUK to the public sector. The Council welcomed this opportunity to understand how PUK operated commercially, while maintaining its remit to work exclusively for the public sector.

6. Look Forward

The Council plans to hold two meetings in 2002. The Council will continue to monitor the growth and trends in PUK's business activity. The Council has asked Partnerships UK to develop a further code of conduct dealing with potential conflicts of interest arising from its general business activities, to be published in the spring of 2002. The Council will also consider the work of Partnerships UK Finance which is presently under development.

As Chairman I will be seeking to bring new members onto the Council to continue to represent a cross section of Partnerships UK's clients.

The Council will also continue to be used as a forum for exchanging information about different PPP projects in different sectors, and the role which PUK can play in assisting PPP development.

7. Conclusions

I believe that the Council has made a successful start and I would like to thank personally those colleagues that have dedicated time to serving on the Council during the year. I believe the Council is operating as a proper check and balance on Partnerships UK's work, and that our work during 2001 has assisted PUK in delivering its public sector mission.

Under the terms of reference for the Council, it is for Treasury Ministers and the Scottish Minister of Finance to decide whether to publish this first Annual Report. Having consulted my fellow members, I can confirm that the Council would welcome such publication.

Sir Andrew Turnbull
Permanent Secretary to the Treasury
January 2002

MEMBERSHIP OF ADVISORY COUNCIL DURING 2001

Member	Organisation	Notes
Sir Andrew Turnbull	HM Treasury	Chairman
Jimmy Andrews	Glasgow City Council	
Colin Balmer	Ministry of Defence	
Ken Beeton	Department for Education and Skills	
Jeannie Bevan	National Savings	
Dr John Bridge	One North East	
Brian Briscoe	Local Government Association	
Pat Carvill	Department of Finance Northern Ireland	Supported by Jim Livingstone
Jeremy Colman	National Audit Office	
Richard Douglas	Department of Health	Succeeded Colin Reeves in May 2001
Dave Fletcher	British Waterways	
Peter Gershon	Office of Government Commerce	
Ken Gillespie	Kirklees Council	
Les Haugh	Home Office	Succeeded John Gieve in June 2001
Sir Richard Mottram	Department for Transport, Local Government and the Regions	
Dr David Owen	Medical Research Council	Retired from Council in September 2001
David Richards	National Assembly for Wales	Supported by Nick Patel
Sandy Rosie	Scottish Executive	Succeeded John Henderson in September 2001
Dr Janet Thompson	Forensic Science Service	Retired from Council in September 2001
John Yard	Inland Revenue	

TERMS OF REFERENCE

1. Background

Partnerships UK ("PUK") was launched in June 2000 to build upon the success of the Treasury Taskforce and to provide a permanent and sustainable centre of expertise to continue the Treasury Taskforce's role in developing and expanding the Government's PPP programme. PUK has absorbed the activities and transaction staff of the Treasury Taskforce. The policy arm of the Treasury Taskforce has transferred to OGC.

PUK's objective is to be at the forefront of the development and implementation of better, faster and stronger PPP transactions, helping to deliver value for money public services and efficient utilisation of public sector assets. PUK will work with central and local government and with other public bodies across the public sector.

PUK has undertaken a capital raising exercise. This involved the sale of shares by HM Treasury and the raising of new equity. On completion of the capital raising, 51 per cent of PUK plc's issued share capital is held by private sector shareholders with the balance held by HM Treasury (44.6 per cent) and the Scottish Ministers (4.4 per cent). PUK is itself a public private partnership with a public sector mission and will aim to achieve a rate of return for its investors which is commensurate with the risks of its businesses.

For the time being, PUK intends to concentrate on five business activities:

- working as a co-sponsor on specific PPP projects;
- making equity investments in Wider Markets projects;
- providing support to central and local government and other public bodies;
- offering on balance sheet loan products for PPP projects; and
- making investments in New Initiatives.

In carrying out these five business activities PUK will seek at all times to follow its public sector mission. The public mission is enshrined in the object clause of the Memoranda

"To assist governments (whether local, municipal, regional, national, devolved, supreme, state, federal or otherwise and whether of the United Kingdom or elsewhere) and other public bodies in the United Kingdom and elsewhere in the development, procurement, financing, management and implementation of public private partnership projects (being projects and undertakings the resources for which are provided partly by public bodies and partly by private persons) by entering into joint ventures, by participating in public private partnership projects with private persons or by acting as an investor, consultant or otherwise, and to promote the development and use of public private partnerships generally."

The agreement of the holders of the "B" Ordinary Shares is required for the conduct, as the main business of PUK plc, of any business other than the public sector mission as defined above.

PUK's corporate governance structure has been established to balance its private sector ethos and management with its public sector mission. Key components are the Board and the Advisory Council.

The Board will comprise a majority of Directors from the private sector. HM Treasury, as holder of the majority of the "B" Ordinary Shares, will have the right to appoint two Directors, each of whom is expected to be non-executive.

The text below describes the role of the Advisory Council. It is taken from the draft Information Memorandum for the capital raising.

In support of the public sector mission, HM Treasury has established an Advisory Council. The Advisory Council will be chaired by Sir Andrew Turnbull, Permanent Secretary to the Treasury, and will consist of representatives from Government departments, the Devolved Administrations, local authorities and other public bodies that are amongst PUK's most significant clients. Details of the current members of the Advisory Council are set out in the Appendix. HM Treasury, as holder of the majority of the "B" Ordinary Shares, will have the right to nominate the individual members of the Advisory Council.

As set out in the Articles of Association of PUK plc, the Advisory Council will meet twice yearly with the Directors to review the effectiveness of PUK in fulfilling the public sector mission set out in the objects clause of the Memorandum of Association and will send a report at least once per year on PUK to Treasury Ministers and it is the current intention of HM Treasury that this report will be published. The first Advisory Council meeting will be in the first quarter of 2001. The Advisory Council will have the option of meeting more frequently if required. The Directors must provide all information reasonably required for the Advisory Council to conduct an effective review.

The Advisory Council will not have any executive authority over PUK. However, the Directors must have regard to the conclusions of the Advisory Council in formulating their plans for the forthcoming year.

Amongst other factors, it is expected that the reviews will focus on:

- the past and future business activities of PUK;
- the market sectors in which PUK is active;
- the selection criteria by which PUK chooses the projects in which it participates; and
- the Directors' response to any queries previously raised by the Advisory Council.

The full text of the relevant parts of the Articles of Association are set out below.

2. Terms of reference

The role of the Advisory Council is to review the scope of Partnerships UK's public sector mission and the manner in which it is being carried out. The Advisory Council will:

- represent generally the interests of the public sector in its dealings with PUK;
- act as a forum for discussing any concerns of the public sector in its dealings with PUK;
- review the ongoing business activities of PUK and in particular
 - the types of PPP projects in which PUK is engaging
 - Sector coverage
 - Geographical coverage
 - Spread of activity across central and local Government
- review new business initiatives of PUK;
- review the methodology and criteria used for selecting projects; and
- review the application of selection criteria.

3. Procedures

The following procedures will be adopted by the Advisory Council:

- The Advisory Council will meet twice a year at six monthly intervals; the Chairman's office will arrange meetings.
- The Chairman's office will be responsible for preparing and distributing the minutes.
- Minutes of the meeting will be circulated to the Chief Secretary, the Scottish Minister of Finance, 'B' Shareholders, members of the Advisory Council, and the PUK board.
- The Chairman will prepare reports of the meetings once a year. The reports will be submitted to The Chief Secretary and the Scottish Minister of Finance
- If required the Management of PUK will meet with the Chief Secretary and the Scottish Minister of Finance to review the report.
- Following submission to the Ministers, and subject to their consent, the reports will be published on the Partnerships UK website and placed in the House of Commons library and the Library at the Scottish Parliament

Extract from PUK Articles of Association

Establishment of Advisory Council

- A.14 The holder or holders of a majority of the "B" Shares will be entitled to appoint an Advisory Council, comprising such public and/or private sector representatives as the holder or holders of a majority of the "B" Shares may think fit.

Sanctions required for certain events

- A.12(1) Notwithstanding any other provision of these articles to the contrary, the Company and the directors will procure that none of the following events will occur without the prior sanction of an ordinary resolution passed at a general meeting of the Company duly convened and held, for which purpose the provisions of article 12(2) shall apply:

(a) the conduct, as the main business of the Group, of any business other than the Public Sector Mission;

(b) the variation of any rights attached to any shares in the Company in so far as such variation affects the rights attached to the "B" Shares;

(c) the purchase by the Company of, and/or cancellation of, any of the "B" Shares;

(d) any arrangement whereby the management control of the Company is indirectly or directly exercised by parties other than the Board.

- A. 12(2) In the event of any resolution being proposed at a general meeting of the Company pursuant to paragraph 2(1) above, each of the "B" Shares then in issue will on a poll in respect of such resolution carry the right to such number of votes as confer on the holder or holders of the "B" Shares present at such meeting in aggregate 95% of the votes exercisable on a poll in respect of such resolution.

Public Sector Mission

- A. 100. No more than 30 days after the end of each financial year of the Company (or by such other time as the Advisory Council may from time to time agree with the directors) the directors will provide to the Advisory Council such information as the directors will reasonably consider necessary in order to enable the Advisory Council to review the Company's effectiveness in fulfilling the Public Sector Mission during the course of the relevant financial year.

- A.101 Each year, as soon as practicable following the receipt by the Advisory Council of the information provided by the directors pursuant to article 3, the directors will meet with the Advisory Council to review the Company's effectiveness in fulfilling the Public Sector Mission during the course of the relevant financial year and at such meeting the directors will provide such further information in connection with such fulfilment as the Advisory Council may reasonably request. The directors must have regard to the views of the Advisory Council in relation to the Public Sector Mission in their plans for the Group for the forthcoming year.
- A.102 The directors will in addition meet with the Advisory Council between 6 and 7 months after the meeting referred to in article 100 to review the Company's progress in relation to the Public Sector Mission.
- A.103 The Chairman of the Advisory Council will submit a formal report on the Advisory Council's proceedings at least once a year to the holder or holders of a majority of the "B" Shares who may, acting in their sole discretion, release such reports for publication.

SELECTION CRITERIA

The Advisory Council approved the following paper at its meeting on 22nd May 2001.

1. Introduction

This paper sets out the selection criteria that Partnerships UK ("PUK") proposes to use in choosing transactions on which it will work with public bodies. The Advisory Council has reviewed these selection criteria and endorsed them as appropriate and consistent with PUK's public sector mission.

2. Selection Criteria

The criteria are largely an inheritance from the criteria used by the Treasury Taskforce in selecting its "Significant Projects", and are seen as having the merit of ensuring that only projects with a specific feature or features, that make them particularly important to the Government or to a part of the public sector, are chosen. They are also aimed at being sufficiently broad to allow some discretion to the management team in not being bound to select projects that may be inappropriate for PUK to be involved in. In practice, in many if not most cases, projects selected will meet more than one aspect of the criteria - for example, if they are large, they are often also complex and/or politically sensitive, whilst innovative projects often also set replicable models. The selection criteria will be used to help PUK identify transactions where it can add the most value and fall under a number of headings:

Project Criteria

1) Primary Criteria

Large - Large projects tend to have their own complexities, and, because they tend to have a high profile due to their size, are seen in the market as setting important precedents. PUK's remit is to help deliver good VFM PPPs more quickly and setting good precedents on large deals helps meet this objective. Current projects in this category include the Barts London Trust and the MoD Aquatrine project.

Complex - The PUK involvement in complex projects is again driven by the need to help deliver deals more quickly. The range of expertise available within the PUK team and the relationships and experience across the PPP market can make a significant contribution to the delivery of, and the VFM achieved by, particularly complex deals. Aquatrine is again a good example, but so also are many of the smaller, one-off deals that will be worked on by the Science and Technology and Wider Markets teams within PUK.

Small and replicable - Setting replicable models is an important part of PUK's role in developing new PPP markets. It also contributes to the work that PUK does in the area of developing guidance on contract terms and standard form

contracts. For example the involvement with both East Lothian and Midlothian schools projects is predicated on establishing clear precedents for, respectively, refurbishment focussed projects across entire estates of schools, and establishing a community campus with more cost effective provision of school buildings enabling wider community facilities to be developed.

Innovative - Innovative deals often run into problems that were difficult to foresee at the start of the project, and might involve new commercial structures, relations between public sector bodies or a need for a novel financial structure. PUK is uniquely well placed to respond to the emerging issues of an innovative project, and to share the lessons that emerge where they are relevant to other projects or sectors. The British Waterways Water Grid project is clearly innovative in attempting to address an issue that has not previously been tackled in a structured way, as will be many of the joint ventures PUK is expecting to establish - for example with the Scottish Tourist Board.

Politically sensitive - Politically sensitive projects often attract their own complexities, or are of a particular priority to the government, and so PUK's expertise in helping facilitate successful and timely delivery is particularly important. Projects that have arisen out of the peace process in Northern Ireland are a good example.

2) Secondary Criteria

Geographical spread - PUK will seek to make its services available in all parts of the United Kingdom. PUK is currently working on projects in England, Northern Ireland, Scotland, and Wales.

Sector spread - PUK will seek to diversify its resources across the relevant sectors where PPPs are being deployed. PUK has appointed sector coordinators to ensure that opportunities are being identified across the sector range. This coverage includes both central and local government.

Public Body Criteria

PUK's normal method of engagement is via a Development Partnership Agreement. This requires the public body to accept the partner/joint sponsor role of PUK. Therefore in reviewing a potential project PUK will assess:

1. The project team and in particular their likely acceptance of PUK's role. NB this does not necessarily mean the competence of the project team;
2. The decision making process and decision making structure of the public body; and
3. The stage of the procurement.

PUK's Risk and Reward

All transactions will be subject to the approval of PUK's investment committee. The investment committee will focus on the value added for the public sector as well as rigorously reviewing the transaction from a risk and return perspective. In general the interests of PUK and public bodies should be aligned.

CODE OF PRACTICE ON SHAREHOLDER RELATIONS

This Code of Conduct is the first of a series produced by Partnerships UK for its stakeholders, its clients, its employees and its shareholders. The Codes will address issues arising from Partnerships UK's role as a PPP and its public sector mission.

INTRODUCTION

1. Following the Treasury's sale of its majority stake in Partnerships UK plc (PUK), PUK is now a public private partnership in its own right, with 51% of its shares owned by the private sector, and 49% owned by the Treasury and Scottish Ministers. No private sector shareholder holds more than 8.8% of the shares in PUK.
2. This Note sets out how PUK will operate in its dealings with its shareholders, and the safeguards that exist for the public sector when it uses PUK. The relevant audit bodies for national and local government and the NHS in England, Wales and Northern Ireland have been consulted in its preparation. Audit Scotland has not been able to comment on the development of this particular Code, but PUK will continue to seek Audit Scotland's views on future codes.

PUK'S CONSTITUTION

3. PUK's public sector mission is enshrined in its constitution. PUK will work for the public sector, and only for the public sector. An Advisory Council (made up exclusively of public sector appointees) oversees the work of PUK, and the Treasury retains a significant interest in PUK's work.
4. The directors of PUK are drawn from the public and private sector (two of whom are nominated by HM Treasury). No director has been nominated by a private sector shareholder or holds a remit to serve any individual private sector shareholder. All directors are required to declare any interests on a matter coming before the Board of PUK.

PUK'S COMMITMENT TO THE PUBLIC SECTOR

5. PUK is committed to serving the public sector well, and helping to deliver better, faster, stronger PPPs. As part of this commitment PUK will be transparent about its activities. PUK understands that it must be seen to act with the utmost propriety in all its activities. Moreover, the directors and employees of PUK must serve, and be seen to be serving the interests of the public sector to the highest standard.
6. PUK has adopted this internal code of conduct to govern its relationships with its shareholders. The code is of relevance to PUK's public sector clients, its directors, its employees and its shareholders. It

addresses specifically the use of information within PUK and deals with concerns about conflicts of interest caused by PUK having private sector shareholders.

USE OF INFORMATION

7. PUK understands that it is important that public bodies can rely upon PUK to keep information confidential. In relation to the use of information within PUK, the following code has been adopted:
 - All PUK employees and associates will have contractual obligations of confidentiality in their terms of engagement, and PUK's terms of business with the public sector will stipulate non-disclosure of confidential information;
 - If requested PUK will require its employees and associates to enter into individual non-disclosure undertakings on specific projects;
 - Project-specific information that is shared with the Board of PUK will be limited to information relating to the commercial position of PUK; i.e. the risks to be taken by PUK under a Development Partnership Agreement. If information relating to an individual procurement process needs to be put to the Board e.g. the evaluation of tenders it will be rendered anonymous. The PUK Board will never have a role in tender evaluation on a project;
 - Shareholders will not have access to specific project information that is not in the public domain.

8. On this basis PUK is confident in stating that PUK will not make improper disclosure of information in its control and that, in particular, PUK's private sector shareholders will have no privileged access to information relating to PUK or its public sector clients.

CONFLICTS OF INTEREST

9. PUK does not believe its status as a PPP should give rise to any conflict of interest concerns for the public sector. A number of factors contribute to this belief:
 - A public body retains control over its procurement decisions and it is not in PUK's power to make decisions about the award of a PPP contract;
 - PUK's directors are not nominated by its private sector shareholders, and hold no remit to represent any individual private sector shareholder;
 - PUK has no commercial interest in its shareholders. PUK will not own shares in its shareholders, and will not enter into contracts with its shareholders for the receipt of or the provision of services. This means that PUK could not be

asked by a shareholder to accept remuneration for promoting the interest of the shareholder on a particular PFI/PPP deal.

- Any involvement of a PUK shareholder in a procurement will be entirely transparent to the public sector client.
10. In order to provide added reassurance, PUK has adopted the following code of practice:
- PUK will always put the interests of its public sector client before the individual interests of a shareholder;
 - PUK will publish the other interests of its Directors on its website;
 - PUK's employees will make annual declarations of any personal shareholdings in PUK's private sector shareholders;
 - In the event that PUK is supporting the public sector on a project and is aware that one of its shareholders is involved in any part of the bidding process, PUK will:
 - Formally notify relevant public sector clients as soon as it becomes aware of the involvement; and
 - Agree with the public sector client a procedure for dealing with any potential or perceived conflicts.

CONCLUSIONS

11. This Note has been approved by The Advisory Council. It has been sent to all shareholders in PUK.
12. PUK believes that its status as a PPP will produce real benefits for the public sector. PUK is happy to answer any questions the public sector may have about its new role.