Portsmouth CITY COUNCIL

Agenda item:

Title of meeting:	Environment & Community Safety Decision meeting
Date of meeting:	14th November 2014
Subject:	Waste Disposal Contract
Report by:	Head of Transport & Environment
Wards affected:	All
Key decision:	Yes
Full Council decision:	No

---

1. Purpose of report

1.1. The purpose of this report is to outline the options currently available for the future of the waste disposal contract and recommend a change to the existing contract.

2. Recommendations

2.1. To extend the household waste disposal contract, in line with the existing contract provision from its current expiry in 2023/5 to a co-terminus date of 2030. This is subject to agreement by all parties including the contractor and partner authorities.

2.2. That authority is delegated to the Head of Service for Transport & Environment, S151 Officer and City Solicitor to work with partner authorities to deliver the required changes in contractual arrangements.

3. Background

3.1. Portsmouth City Council (the city council), along with Hampshire County Council (HCC), Southampton City Council (SCC), is a Waste Disposal Authority (WDA) and has a statutory duty for the disposal of municipal waste arising in Hampshire. In order to fulfil this function the three WDAs have each entered into a service contract with Veolia Environmental Services Hampshire (Veolia) for the treatment and disposal of household waste.

3.2. All 14 waste authorities of Hampshire (Disposal and Collection) are partners, along with Veolia, in Project Integra, the collective and integrated waste management system for Hampshire.

3.3. HCC manages the contract on behalf of the city council and SCC under a tripartite agreement which was agreed in 2009.

3.4. Any changes to the joint arrangements will requirement from the other WDAs, and HCC and SCC will be seeking similar approvals through their decision making processes.

3.5. The tripartite agreement establishes a cost and income sharing mechanism based on input percentages for both the main waste contract infrastructure and the Household Waste Recycle Centre network. The agreement also establishes Service Level Agreements for the additional contract and data administration that the HCC delivers on behalf of the city council.

3.6. This integrated approach to waste management was novel for the UK when introduced by Hampshire in the early 1990's in response to a shortage of landfill, and public demand for greater recycling. As a result of this approach, and an investment of c. £200million, a world class suite of infrastructure has been delivered through Veolia's waste management contract. This includes:
- 3 Energy Recovery Facilities (ERFs);
- 2 Material Recovery Facilities (MRFs);
- 2 Composting Facilities; and
- 10 Transfer Stations.

3.7. The current contract with Veolia is for a period of 20 years from the commissioning of the ERFs (2003, 2004 & 2005 in DC1 (North), DC3 (West), and DC2 (East) respectively).

3.8. There is a provision within the contract (Articles of Agreement 3.1.2) for an extension for a further period of up to 10 years.

3.9. The nature of the Public Private Partnership contract put a high level of risk onto Veolia. Examples of the risk held by Veolia include:
3.9.1. Risk of investing and building the assets;
3.9.2. Operational risk (e.g. achieving availability of assets, capital, and maintenance costs); and
3.9.3. Risk of (upside and downside) income e.g. energy, recycle, profit generated by selling spare ERF capacity to other parties (i.e. commercial and industrial (C&I)).

4. Performance

4.1. Project Integra was seen as a 'leader' amongst its peers based upon one of the pathfinder Public Private Partnership waste management contracts, and upon its leading financial performance. The investment, coupled with the waste management agreement, has enabled the partnership to perform ahead of its peers against a number of performance metrics:-
4.1.1. National leading landfill diversion rate (Hampshire County Council 93.73 in 2012/13)
4.1.2. Contract variations have been agreed over the past 17 years which have released savings to the Waste Disposal Authorities. A contract variation agreed in 2009, enabled:-
- c. £1.6M annual discount achieved

- c. £1.5M one off rebate
- Income share arrangements (2013 income share was £6.3M)

4.1.3. Chartered Institute of Public Finance and Accountancy (CIPFA) statistics illustrate Hampshire County Council to be top performing cost per head in comparison to peers

4.2. The city council's performance is this regard is similar, with the percentage of municipal waste being sent to landfill standing at below 10%, which means over 90% of all municipal waste is either recycled, reused or used to generate energy at the ERF.

5. Future strategic direction of waste disposal

5.1. The gross waste disposal contract budget is £5.7m pa. Once income from the sale of recyclable materials and profit share on commercial capacity is added in this reduces the net cost to the city council for this service to £4.7m pa. This represents over 30% overall Environment & Community Safety portfolio budget. As part of the upcoming fiscal constraints, and the need to deliver efficiency savings, a review of the waste disposal contract was undertaken, led by HCC, to determine the optimal way to drive efficiencies and modernise services against a backdrop of emerging EU policy involving rising recycling targets.

5.2. An option appraisal was undertaken to consider the medium to long term strategic benefits and efficiencies from:-

5.2.1. Base case: the current contract arrangements (up to 2023/5);

5.2.2. Scenario 1: an operate-and-maintain partner or alternative delivery model to operate the facilities beyond the expiry of the current contract from 2023/5 up to 2030;

5.2.3. Scenario 2: an extension to the contract to 2030 (invoking the existing contract clause); and

5.2.4. Scenario 3: early termination of the contract with Veolia, moving to an alternative operate-and-maintain partner from 2016/17 to 2030.

An outline of the pros and cons of each scenario is shown in Appendix B.

5.3. HCC (as part of its tripartite role) has led discussions with Veolia to explore the nature of a contract extension for 5-7 years to 2030 to enable efficiencies to be delivered from 2015. A number of options and sub-options were explored to determine if they met the objectives of the value for money review.

5.4. Veolia have put forward an ‘outline’ proposal to the WDAs following those discussions. The financial details of this offer is commercially confidential, and outlined in Appendix A of this report. The offer put forward:-

5.4.1. Will not alter services delivered to the city council under the contract, nor the services delivered to the public;

5.4.2. Will not change the risk profile of the contract to the city council; and

5.4.3. Will enable efficiencies to be delivered from 2015.

5.5. An integral part of the extension is a commitment from Veolia to jointly invest, with the WDAs, in developing and implementing efficiencies to service delivery aligned to emerging policies. HCC is working with its private sector partner, Deloitte, to review the strategic relationship management of this contract to ensure a lean but robust contract management approach which enables all parties to modernise services and deliver efficiencies.

5.6. A Strategic Steering Board has been set up to govern the strategic relationship between the WDAs and Veolia. The Board will embrace a collaborative culture, seeking out innovation and service evolution so that all parties continue to benefit from modern service provision through to contract expiry. The Board will have two main functions:

5.6.1. To review service and partnership performance – Ensure the service is delivered to a high standard as expected under the contract, to collectively make suggestions for efficient management or improvement in relation to the service.
5.6.2. To drive strategic improvement – To be Innovative: Develop and/or consider proposals for service improvement and for greater cost-effectiveness in the delivery of the services on a whole life cycle costs basis, in particular by studying examples of best practice elsewhere. Also, to anticipate and consider proposals for any change in the service that may be required, for example, by any change in law or policy, or by any change in economic or social circumstances or expectations.

5.7. A full review, including financial appraisal, has been undertaken by the consultants supporting the WDAs (Jacobs and Deloittes), along with senior officers from waste management and finance. As a result of a confidentiality agreement between the WDAs and Veolia, the financial details of the options are considered commercially confidential and therefore restricted to Appendix A of this report.

6. Contract negotiations and recommended outcome

6.1. The recommended option is Scenario 2 (extension to the current contract to 2030). This option enables the city council to deliver its medium term strategy and efficiencies working with Veolia to jointly modernise services.

7. Reasons for recommendations

7.1. The review of waste disposal contract has been necessitated by the need for the city council to meet its efficiency savings targets. The decision to pursue the recommended option is supported by a comprehensive consideration of several options including a detailed value for money review (Appendix A).

7.2. The rationale for the preferred option is:

7.2.1. It enables the WDAs to deliver their medium term strategy and efficiencies working with Veolia to jointly modernise services;
7.2.2. Provides certainty of financial benefit i.e. Veolia willing to sign a deal quickly without the need for a resource intensive procurement process;
7.2.3. Veolia have proven their delivery capability which has enabled Hampshire to be a high performing waste management authority;

7.2.4. The advice from HCC is that the relationship with Veolia has improved over the past 18 months. Officers and Members from the city council have met with Veolia to confirm that this is the case.

7.2.5. Veolia take operational and maintenance risk on the aging plant – costs for undertaking this appear consistent with market prices;

7.2.6. Any 'end of contract' risks, such as liquid market, feedstock risks, latent defects, etc, are mitigated for a further 5 years

7.3. The recommended outcome will enable the city council, and its WDA partners, to deliver their medium term strategy and efficiencies by working with Veolia to jointly modernise services. It will also provide certainty of financial outcome as an agreement can be reached without the need for a resource intensive procurement process.

8. Equality Impact Assessment (EIA)

8.1. This report does not require an equalities impact assessment as the recommendations proposed in the report will not have a disproportionately negative impact on any specific equality groups.

9. Head of legal, licensing & registrars' comments

9.1. Base Case: The Contract commenced on 25 March 1997 and is to continue until the end of the *Third Phase*. The commencement of the *Third Phase* varies for each *Contract Area*. The City Council falls within DC2 – south east Hampshire which will expire on 8 April 2025.

9.2. Scenario 1: this will allow for the natural expiry of the current Contract. Thought is to be given as to how the City Council will tender for delivery of the service (and the costs incurred as a result). The city council's obligations as a waste disposal authority must continue to be met.

9.3. Scenario 2: Clause 3.1.2 of the Contract provides that no later than five years before the end of the Contract Period (by 4 April 2020), the parties (HCC and Veolia) shall commence discussions regarding intensions for the provision of waste disposal services after the end of the Contract period. This provision is subject to the agreement of both parties and allows for a possible Contract extension for a further period not greater than 10 years (up to 2035).

9.4. The Tripartite Agreement ("the Agreement") between HCC, the city council and SCC (the (most recent dated 16 October 2009).Clause 11 of the Agreement does provide that no variation is to be made to the Agreement except in writing by all parties.

9.5. If scenario 2 is applied (extension of the Contract within the extension provision) all parties must be mindful to ensure any possible efficiencies (as stated at point 5.4 of the Report) delivered post 2015 do not alter the scope of the service or the risk profile so that they are beyond or materially different from the scope contained within the original OJEU notice.

9.6. Scenario 3: This proposes early termination of the Contract (pre 8 April 2025). The Contract provides for Termination pre the expiry date of 8 April 2025 at Clause 10. Such events are in various cases of Contractor default. Any variation to the contract term outside such contractor default provisions must be in accordance with clause 11 (agreement with both Veolia and HCC).

9.7. The Agreement (at clause 3.1) provides that all parties (HCC, SCC and the city council) would have to be in agreement for such variation. Cost would have to be agreed between all parties as the Contract only provides the procedure for costs in cases of default Termination (clause 10). This option would allow for the current Contract structure to be tidies and all authorities to be signatories to any such varied Contract.

10. Head of Finance's comments

10.1. The scenarios as set out in the body of the report and in Appendix A have been reviewed and financially appraised. Scenario 3 involves the highest potential costs and carries the greatest level of risk.

10.2. Scenarios 1 and 2 have similar overall cost profiles. However, scenario 2 comes with fewer risks and also meets the need of the council to reduce revenue expenditure in 2015/16 and in future years. Under Scenario 1, no financial savings would be realised until 2024.

10.3. Approving the recommendation to choose scenario 2 will allow the city council to make financial savings from 2015/16 and exposes Council to the least risk in respect of benefit realisation and service delivery.

………………………………………………
Signed by:

Appendices:
Appendix A - Financial appraisal of the scenarios (confidential)
Appendix B - Outline of the pros and cons of each scenario

Background list of documents: Section 100D of the Local Government Act 1972

The following documents disclose facts or matters, which have been relied upon to a material extent by the author in preparing this report:

The recommendation(s) set out above were approved/ approved as amended/ deferred/ rejected by ……………………………… on ………………………………

………………………………………………
Signed by:

Portsmouth CITY COUNCIL

Appendix B

Scenario	Pros	Cons
Base Case. Current VES contract up to its natural expiry 2023/5	• Provides flexibility to potentially benefit from new technology or innovations in the market from 2023	• No opportunity to deliver significant savings until after 2023 • Potentially undermine the relationship with Veolia • Need to procure an alternative in 10 years time e.g. O&M extension, long term contract with new assets, joint venture etc
Scenario 1. VES contract (as is) up to 2023, then an O&M contract from 2023/5 to 2030 tendered in the open market	• Opportunity for a new contract with tighter performance KPIs and cultural alignment, that promotes innovation • Could have greater access to waste income and energy income • Ability to optimise opportunities across SE7. Optimise assets, material streams and income share .	• Greater risk sits with the WDAs (3rd party income, availability of the facilities and failure of the facilities). Capital reserves would be required to protect against this. • 9-12 month procurement process with related costs and possible transition to a new provider • New operator (unknown) would present a risk they do not hold the competencies to run an efficient service • Veolia may be the only bidder in 2023 (hold an advantage)
Scenario 2. Extend the existing contract with Veolia until 2030	• Ability to 'smooth cashflow' to access benefits from 2015 • Provides certainty in current budget process • Veolia retain the risks of 3rd party income, availability of the facilities and plant failure • Veolia incentivised to invest in assets and promotes joint WDAs/Veolia innovation over the short to medium term	• Locked into 5 year contract with Veolia with limited opportunity to transform the service delivery model. • Opportunity cost that WDAs could be contractually tied into contract which stops access to the future value of waste as a commodity. The waste market is rapidly changing as secondary raw materials are becoming a valuable commodity albeit in a highly volatile market • WDAs contracts will not have co-terminus end dates with other SE7 authorities reducing the opportunity to collaborate • There is a legal risk of challenge to the extension (although the contract enables a 10 year extension)
Scenario 3. Early termination of the Veolia contract in 2015 and procure an O&M	• Provides flexibility to benefit from greater income share earlier • Opportunity for a new contract with tighter performance KPIs and cultural alignment, that promotes innovation	• Termination cost and resources to negotiate the termination cost could outweigh the potential benefit • 9-12 month procurement process with related costs and possible transition to a new provider • Greater risk sits with the WDAs (3rd party income, availability of the facilities and failure of the facilities). Capital reserves would be required to protect against this. • Market perception of WDAs as a client post termination – could drive bid costs up