

Report of Head of Engineering Services

Report to Director of City Development

Date: 9th December 2014

Subject: Leeds Street Lighting PFI Settlement and Operational Savings

Are specific electoral Wards affected? If relevant, name(s) of Ward(s):	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
Are there implications for equality and diversity and cohesion and integration?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
Is the decision eligible for Call-In?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
Does the report contain confidential or exempt information? If relevant, Access to Information Procedure Rule number: Appendix number:	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No

Summary of main issues

1. The Council entered into a PFI contract with Tay Valley Lighting (Leeds) Limited (**TVL**) in March 2006 for the provision and maintenance of street lighting and illuminated traffic signage in Leeds. TVL has sub-contracted the majority of its obligations to Southern Electric Contracting Limited (**SEC**).
2. The contract is based around 7 Performance Standards, and TVL's entitlement to payment may be adjusted (reduced) on a monthly basis if these performance standards are not met. If no deductions are made, the Council pays TVL a monthly unitary charge of c£1.1m.
3. A number of performance issues have arisen over the course of the contract (as set out in more detail below, and together being the **Disputes**), which the Council considers give rise to the right for the Council to make deductions.
4. Following detailed discussions with TVL, the base data regarding the performance in respect of such matters has been reviewed and the parties have also undertaken a comprehensive review of the reason such performance failures arose, with a view to:
 - 4.1. recovering previous overpayments as a consequence of TVL's failure to report performance failures;
 - 4.2. putting in place effective controls and processes to ensure that similar failings do not arise in future; and

- 4.3. re-affirming the partnership commitments of the parties with a view to achieving the effective performance of the contract, and realising efficiencies and savings where appropriate and where this represents best value.
5. The outcomes of these discussions are that:
 - 5.1. TVL have agreed to pay the Council a lump sum amount of c.£6.6m, which includes deductions due in settlement of the Disputes and £150k of operational savings agreed;
 - 5.2. The parties have agreed 3 separate LED lamp investment programmes, which will bring significant energy savings for the benefit of the Council and related environmental benefits (on average, LED lamps will use approximately half the energy of the existing lamps);
 - 5.3. The Council has agreed that c.£390k is due to TVL on satisfactory completion of various milestone works;
 - 5.4. The Council has agreed variations to the Services which shall:
 - 5.4.1. entitle the Council to further benefit from a lump-sum of £200k of operational savings which shall be off-set against amounts owed to TVL, albeit that this sum may be reinvested back into the Project in due course; and
 - 5.4.2. annual savings of £3,100 (indexed);
 - 5.5. The parties have agreed a full audit of the apparatus management system by July 2015 with the application of deductions if it is less than 99% accurate until such time as it achieves the required minimum level of accuracy;
 - 5.6. TVL has reviewed its management structure, quality assurance processes and clarified its working practices documentation. This settlement will resolve disputes which have been under discussion for many years and which have been impacting on the effective relationship of the parties during such time. While the settlement sum is less than the amount which the Council initially considered due, it represents a very significant lump-sum for the Council to receive at a time when Council budgets are severely stretched. The settlement will avoid future litigation costs, will free up officer resource, will avoid the potential that the Council either loses any litigation or recovers less than the amount currently offered, will avoid the potential that the parties differences are incapable of being resolved/lead to contract termination (with all the attendant service disruption, and additional resource/cost that would entail) and has allowed the parties to focus on how the service may be taken forward on a more effective and efficient footing.

Recommendations

7. The Director of City Development is recommended to:
 - 7.1. agree to the terms of settlement of the Disputes;
 - 7.2. agree to the terms of the related contract variations; and
 - 7.3. to note that (in accordance with the Government's agenda to make savings in operational PFIs):

- 7.3.1. the agreed service variations will realise a lump sum operational saving of c£350k in total, with further annual operational savings of £3,100 (indexed), and;
- 7.3.2. that the agreed LED lamp investment programmes will realise continual energy savings and environmental benefits throughout the remainder of the contract term (the precise quantum of such benefits being dependent upon energy prices, but noting that on average, LED lamps will use approximately half the energy of the existing lamps).

1 Purpose of this report

- 1.1 The purpose of this report is to recommend that the Director of City Development agrees to the settlement of the Disputes and the two claims against the Council.
- 1.2 The Director is advised that, in agreeing to the settlement referred to at paragraph 1.1, the parties release their respective claims against each other in respect of such claims.
- 1.3 Further, the Director is advised that, in accordance with the Government's agenda to make savings in operational PFIs, the Council has:
 - 1.3.1 agreed a variation to relieve TVL from the obligation to undertake interim cleaning of the apparatus which will in turn realise a lump-sum saving of c£350k; and
 - 1.3.2 agreed 3 separate LED lamp investment programmes, which will bring significant energy savings for the benefit of the Council and related environmental benefits.

2 Background information

- 2.1 The Council entered into a PFI contract with Tay Valley Lighting (Leeds) Limited (**TVL**) in March 2006 for provision and maintenance of street lighting and illuminated traffic signage in Leeds. TVL is owned 50:50 by Scottish and Southern Energy plc (**SSE**) and Royal Bank Leasing Limited. TVL has sub-contracted most obligations to Southern Electric Contracting Limited (**SEC**), a subsidiary of SSE. The project is now in the 8th year of its 25 year term, and over 80% of the street lighting and illuminated traffic signage in Leeds has been replaced. The contract is based around 7 Performance Standards, and TVL's entitlement to payment may be adjusted (reduced) on a monthly basis if these performance standards are not met. If no deductions are made, the Council pays TVL a monthly unitary charge of c.£1.1m.
- 2.2 During the contract term, a number of performance issues have arisen which have remained unresolved for some time (the **Disputes**). The Council considers that these performance issues have given rise to rights for the Council to make very significant levels of deductions.
- 2.3 TVL has raised two claims of its own against the Council. Firstly, indexation has been incorrectly applied resulting in a series of underpayments. Also, the contract provides that the risk of energy consumption increases resulting from changes in law relating to BSCP 520 (energy consumption calculations) sit with the Council. Such a change has occurred, resulting in additional payments now being due from the Council
- 2.4 In respect of the latter issue (and the fact that the Council also takes energy price risk), there are consequently significant financial savings (and environmental benefits) that may be realised in the event that energy consumption is reduced.

3 Main issues

- 3.1 Council officers and representatives of TVL have systematically and forensically reviewed the Disputes, the TVL claims and the potential benefits which may be realised from changes to the contract.
- 3.2 The Disputes are as follows:
- 3.2.1 Failure to undertake planned maintenance by way of changing lamps and cleaning apparatus at regular intervals (**Bulk Lamp Change & Clean**);
 - 3.2.2 Failure to reconcile the financial model to take account of fewer heritage lighting columns having been installed than originally anticipated (**Reconciliation of Enhanced Apparatus**);
 - 3.2.3 Failure to apply reporting failure deductions in respect of previously agreed performance failures (**Historic PS7 Deductions**);
 - 3.2.4 Maintenance failures in respect of high-mast apparatus;
 - 3.2.5 Failure to undertake successful electrical tests in subways;
 - 3.2.6 Failure to undertake successful electrical tests in respect of private cable network;
 - 3.2.7 Painting failures;
 - 3.2.8 Failure to maintain an accurate apparatus management system;
 - 3.2.9 Customer contact/survey failures;
 - 3.2.10 Inspection regime failures;
 - 3.2.11 Subway lighting installation issues;
 - 3.2.12 Issues regarding de-accrual of apparatus.
- 3.3 Following review of the performance data in respect of the Bulk Lamp Change and Clean, Reconciliation of Enhanced Apparatus and Historic PS7 Deductions disputes, and consideration of the Council's legal position with the Council's external legal advisors (DLA Piper LLP and Anneliese Day QC), the Council's estimate of the value of its claim was c.£10.3m. TVL denied liability, and considered that to the extent they were liable that the quantum of such liability was very significantly below the Council's estimate.
- 3.4 As is required by the contract, the parties undertook a number of good faith discussions with a view to resolving the dispute. As part of this process, the Council took the opportunity to consider whether other non-cash benefits may be realised which would resolve the other outstanding performance issues, and allow the opportunity for a wider review of contractual performance in order that future issues may be resolved and that an effective, efficient and better value service

may be delivered over the remaining 17 year contract term. Working in partnership with TVL to deliver improvements to the service, would also ensure that the Council would avoid engaging in a costly, disruptive and resource intensive dispute resolution process which had the potential to lead to the termination of the contractual relationship (with the attendant additional cost, service disruption and resource implications that would entail).

- 3.5 Consequently, with a view to undertaking a comprehensive review and achieving a comprehensive resolution of all outstanding issues, all such issues of which the parties were aware were brought to the table for resolution.
- 3.6 The outcome of these discussions is that TVL has now offered the Council a lump-sum payment £6.6m in settlement of the Disputes. This settlement includes a lump-sum payment of over £2m in settlement of the Reconciliation of Enhanced Apparatus dispute, rather than the c.£20k reduction in monthly payments over the remainder of the contract term.
- 3.7 Further, the Council and TVL have agreed 3 separate LED investment programmes – one in subways, one in tunnels and one on various roads which currently have the largest proportion of high energy lamps. The subway programme is worth £50k and will be paid for by TVL by way of a reduction to the monies owed by the Council, with the energy savings shared 50:50. The other two investment programmes are at the Council's cost and total £670k, however the majority of energy savings from these schemes are for the Council's benefit. It should be noted that LED lamps consume on average approximately half the energy of the existing lamps. Each of these investment programmes would be therefore be classified as operational PFI "savings" given the significant energy savings that will be realised over the remainder of the contract term, and they also bring obvious environmental benefits.
- 3.8 TVL is also in the process of undertaking a thorough review of the accuracy of the apparatus management system. This is due to be completed by July 2015, at which date a joint audit will be undertaken with a view to confirming that the database is at least 99% accurate. If this is not the case, the Council will be entitled to make deductions each month until the database reaches this minimum level of accuracy.
- 3.9 As part of the service review undertaken, as is standard practice in many other street lighting PFIs, the Council and TVL have agreed that the interim apparatus cleaning requirement under the contract be removed. This will realise a lump sum saving of £350k, £150k of which is included in the £6.6m settlement figure and the other £200k is set-off against amounts owed to TVL by the Council (see para 3.10). In order that the impact of this variation on ongoing performance is mitigated, tunnel cleaning and illuminated traffic sign/bollard cleaning will continue unaffected by this change, apparatus will still be cleaned as part of the bulk lamp change and clean process, and TVL will still be required to ensure that apparatus is performing to the required light output. An annual survey of apparatus will be undertaken to check whether any ad-hoc cleaning is required. The survey and ad-hoc cleaning will be at the Council's cost, subject to a cap of £3k in respect of the survey and £200k in total in respect of any surveys or ad hoc cleaning required over the remainder of the contract.

- 3.10 The Council owed TVL c.£591k in relation to energy consumption increases arising in relation to a BSCP 520 change in law and underpayments relating to the application of incorrect indexation. As noted above, this sum shall be reduced by £200k as a consequence of the removal of the majority of the interim apparatus cleaning requirements (see para 3.9). Regarding the remaining £391k owed by the Council, this is effectively being held by the Council as a bond and will only be released to TVL following completion of various work milestones by TVL (e.g. painting, column numbering, de-accrual of apparatus).
- 3.11 The Council has also worked with TVL in respect of a review of TVL's working practices and processes, and to agree a partnership charter to ensure that the performance issues encountered to date are not repeated. TVL have also replaced the senior management team responsible for the contract, replaced a number of underperforming sub-contractors and put in place a much more rigorous management structure and quality assurance framework to ensure that (amongst other things) more accurate records of works undertaken by sub-contractors are maintained. While copies of SEC's new written procedures and their audit plan have not yet been received, the changes have been considered by the Council's internal audit team and it is considered that they will help to provide some assurance over their future activities.
- 3.12 The settlement only applies to the Disputes and as such if any further past issues come to light, Council has reserved its position and would be entitled to raise further claims/take further action.
- 3.13 A settlement agreement has been drafted which provides for settlement and release of the Disputes and the claims against the Council following payment of the settlement sum. A deed of variation has also been drafted which provides for the various service changes.
- 3.14 DLA Piper LLP has confirmed that the overall settlement package is within a range of outcomes that it was reasonable for the Council to seek to achieve, and that it is reasonable for the Council to determine that it is appropriate in this case to settle its claims for the proposed amount, including for the reasons set out below:
- 3.14.1 there is a legitimate need for the authority to take account of the long term nature of the contractual relationship with TVL and insistence on full compensation could ultimately have a greater adverse impact in terms of undermining TVL's ability to perform the contract;
 - 3.14.2 the benefit of settling a case pre-litigation, where the full details of the case have not been formally developed or analysed;
 - 3.14.3 it is reasonable from a commercial perspective to allow a discount for accelerated receipt of the settlement monies, to account for the avoidance of irrecoverable legal costs of any adjudication or possible subsequent litigation and to take account of the avoided cost of Council officers being diverted to the task of managing the litigation rather than being able to focus on more productive aspects of their jobs; and

- 3.14.4 the Council is not simply accepting a lump sum payment in relation to historic compensation but is also entering into an agreement to ensure that TVL now takes positive steps to bring its contractual performance back into line with the requirements of the contract.

4 Corporate Considerations

4.1 Consultation and Engagement

- 4.1.1 City Development/Highways and Transportation officers, the Executive Solicitor and Executive Project Manager PPPU&PU, the street lighting PFI project board, the Deputy Chief Executive and Legal Services officers have been involved in and consulted in respect of this matter. In addition, the Executive Member for Transport and the Economy, the Leader of the Council, the Leader of the Conservative Group and the Leader of the Liberal Democrat Group have been consulted. External legal advice and support has been sought from DLA Piper LLP and Anneliese Day QC throughout the process. The Department for Transport has been informed of progress throughout and has confirmed that it considers that the settlement and related variations do not appear to involve any changes in PFI principle or derogations that would require its approval and that they therefore view this as an authority decision.

4.2 Equality and Diversity / Cohesion and Integration

- 4.2.1 This was not considered as part of this decision process as it does not affect the subject matter of the decision. However, such issues were appropriately considered at the time of procuring the Project.

4.3 Council policies and City Priorities

- 4.3.1 This decision supports numerous Council values, policies and the Council vision. Some examples being spending money wisely, being open honest and trusted, being fair, having a prosperous and sustainable economy, facilitating successful communities. It also accords with the Council's priority to maintain strong relationships with partners to deliver the best outcomes for local people.
- 4.3.2 Robust management of contracts is a key objective of the Council's procurement strategy, and in this case has achieved the outcomes for the Council set out in this report.

4.4 Resources and value for money

- 4.4.1 The decision will settle disputes which have been under discussion for many years. While the settlement sum is potentially less than the amount which the Council may have secured through formal litigation, it represents a very significant lump-sum for the Council to receive at a time when Council budgets are severely stretched (noting also that c£4m of the initial Council claim was payable over the remaining 17 year contract term).
- 4.4.2 The settlement will avoid future litigation costs, will free up officer resource, will avoid the potential that the Council either loses any litigation or recovers less than the amount currently offered, will avoid the potential that the parties differences

are incapable of being resolved/lead to contract termination (with all the attendant service disruption, and additional resource/cost that would entail) and has allowed the parties to focus on how the service may be taken forward on a more effective and efficient footing.

- 4.4.3 In terms of the monies owed by the Council to TVL, these are effectively being held by the Council as a bond and will only be released to TVL following completion of various work milestones in order to remedy various of the service failures which led to the Disputes (e.g. painting, column numbering, de-accrual of apparatus).

4.5 Legal Implications, Access to Information and Call In

- 4.5.1 Agreement to the recommendations of this report will result in the settlement and release of the Disputes and the claims against the Council. The decision is a significant operational decision pursuant to Article 13.5(b) of Part 2 of the Council's constitution and as such is not eligible for call in.
- 4.5.2 The City Solicitor has been consulted on and has approved the terms of settlement insofar as such approval is required by the Officer Scheme of Delegation in the Constitution.

4.6 Risk Management

- 4.6.1 The claims to date have presented a significant risk to the Council, in terms of the value of the deductions that it is appropriate to make and the ongoing underperformance by TVL. While the Council considers that it may have been able to recover in excess of the sum agreed in settlement of the Disputes, there is clearly an inherent risk in respect of any third party review of the party's respective positions which may have resulted in a determination that less than the agreed settlement sum should be recovered by the Council. By agreeing this settlement, such risks have been avoided. Discussions regarding the settlement of the claims have also allowed the parties to think constructively as to how past performance issues may be avoided in future, has resulted in a very significant overhaul of policies and personnel within TVL and has allowed the parties to agree variations and investments which will result in very significant financial and environmental benefits throughout the remainder of the contract term, providing a more efficient and better value service. The risks arising as a consequence of the variation to remove the interim apparatus clean from the contract is mitigated as set out at paragraph 3.9.

5 Conclusions

- 5.1 Following a long and intensive period of review of the Disputes and the claims against the Council, the opportunity for a reasonable settlement is now available. This will enable the parties to move on in partnership over the remaining 17 years of the operational period of the contract, providing a valuable service to the residents of Leeds and the opportunity for the Council and TVL to work together to consider how continued efficiencies, savings and environmental benefits may be achieved and to deliver a better value service (which savings accord with the Government's operational PFI savings agenda).

6 Recommendations

The Director of City Development is recommended to:

- 6.1 agree to the terms of settlement of the Disputes;
- 6.2 agree to the terms of the related contract variations; and
- 6.3 to note that (in accordance with the Government's agenda to make savings in operational PFIs):

6.3.2 the agreed service variations will realise a lump sum operational saving of c£350k in total, with further annual operational savings of £3,100 (indexed), and

6.3.3 that the agreed LED lamp investment programmes will realise continual energy savings and environmental benefits throughout the remainder of the contract term (the precise quantum of such benefits being dependent upon energy prices, but noting that on average, LED lamps will use approximately half the energy of the existing lamps).

7 Background documents¹

- 7.1 None.

¹ The background documents listed in this section are available to download from the Council's website, unless they contain confidential or exempt information. The list of background documents does not include published works.