

Report of Head of Waste Strategy & Infrastructure

Report to Chief Waste Management Officer

Date: 28th June 2017

Subject: Variation of Waste PFI contract in relation to 2016/17 recycling performance

Are specific electoral wards affected? If yes, 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 checked="" type="checkbox"/> Yes <input type="checkbox"/> No
Does the report contain confidential or exempt information? If relevant, access to information procedure rule number: 10.4(3) Appendix 1 to this report has been marked as exempt under Access to Information Procedure Rules 10.4 (3) on the basis that it contains information relating to the financial or business affairs of any particular person (including the authority holding that information) which, if disclosed to the public, would, or would be likely to prejudice the commercial interests of that person or of the Council. The information is exempt if and for so long as in all the circumstances of the case, the public interest in maintaining the exemption outweighs the public interest in disclosing the information. In this case the report author considers that it is in the public interest to maintain the exemption.	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No

Summary of main issues

1. This report provides details of 2016/17 recycling performance for the Recycling and Energy Recovery Facility (RERF) operated by Veolia, and highlights issues that have impacted negatively on this area of performance since full service commencement. These are a combination of mechanical problems experienced in the Mechanical Pre-Treatment (MPT) facility which extracts materials from recycling at the front end of the process, and issues with securing markets for some of the materials captured.
2. The report outlines the significant range of measures implemented and planned by Veolia to resolve these issues, including the development of a paper pulping facility at the rear of the RERF site which will accept all of the paper and card extracted from the black bin waste and will use heat supplied from the RERF in the process.
3. The report also provides details of a financial settlement, initially proposed by Veolia and developed through negotiation by the Council, in light of the recycling performance shortfall in 2016/17. The details are provided within confidential Appendix 1 to this report.

4. This settlement would be in lieu of the issue of a Performance Warning Notice, which would be the default remedy under the PFI contract for a failure against this annual Key Target. The report seeks Chief Officer approval to implement this variation from the application of the remedy provided for within the contract in this regard.

Recommendations

5. The Chief Waste Management Officer is recommended to:
 - a) note the contents of this report;
 - b) approve and implement the proposed contract variation to accept Veolia's financial settlement detailed within confidential Appendix 1, in return for the waiver of the issue of a Performance Warning Notice in relation to Veolia's failure to meet the Annual Key Target for recycling for 2016/17 under the Residual Waste Treatment PFI Contract.

1. Purpose of this report

- 1.1 This report provides details of 2016/17 recycling performance for the Recycling and Energy Recovery Facility (RERF) operated by Veolia, and highlights issues that have impacted negatively on this area of performance since full service commencement. The report outlines the measures implemented and planned by Veolia to resolve these problems, but also seeks approval to a variation from the application of the remedies provided for within the contract to address this performance shortfall.

2. Background information

- 2.1 The key objectives of the Residual Waste Treatment Project contract are to use waste as a resource, reduce waste to landfill and increase recycling.
- 2.2 The facility started accepting waste for commissioning at the end of October 2015 and by the end of March 2016 was deemed to have attained the Acceptance Certificate and reached Full Service Commencement.
- 2.3 In most respects the RERF has been highly successful, exceeding its expected landfill diversion performance by diverting over 99% of black bin waste from landfill and providing enhanced turnaround times for the refuse collection service. Although not eligible to count towards the Council recycling performance indicator, almost all of the outputs from the RERF process (i.e. post-incineration metals, bottom ash and flue gas treatment residues) are being recycled and used beneficially. The RERF contract is also providing savings to the Council of around £7m per annum compared to the projected costs of the previous reliance on landfill.
- 2.4 However, problems have been experienced with the Mechanical Pre-Treatment (MPT) element of the facility, which extracts the recyclable materials at the front end of the process, with it falling well short of intended performance levels and the achievement of the annual target to recycle 10% of all waste processed at the RERF.
- 2.5 The MPT element of the process required a further level of performance testing under the Contractor's MPT sub-contract, which was due to occur subsequent to the issue of the Acceptance Certificate. This is the process through which the equipment is fine-tuned and optimised whilst already processing waste in order that the capacity, efficiency and purity levels guaranteed in the sub-contract can be demonstrated as having been achieved.
- 2.6 Before these tests were scheduled to take place in early 2016/17, a number of mechanical issues started to develop with the equipment, with Veolia also citing problems in securing markets for some of the materials extracted, in particular paper and card which represents around a half (by weight) of the material required to meet the contractual recycling performance target.
- 2.7 Since this time, Veolia have introduced a range of measures to address the mechanical issues in the MPT facility including the replacement of key components, improved access for cleaning and enhanced cleaning schedules. However, the mechanical problems have persisted during the course of 2016/17, with Veolia missing their quarterly recycling targets and the Council issuing Improvement Notices in accordance with the contract. Veolia have since concluded that a more fundamental replacement of equipment in the ballistic separation stage of the MPT process is required, and this is scheduled to occur in August 2017.

- 2.8 In terms of the recycling market issues being experienced, which are largely borne out by the Council's own knowledge of and involvement with this sector, Veolia continue to work to improve the quality of their outputs and conduct trials with materials reprocessors. However, in respect of paper and card, they have now secured planning permission for and constructed a paper pulping facility (PPF) at the rear of the RERF site on a portion of land leased to them by the Council. The PPF is intended to accept for processing all the paper and card extracted at the RERF, using heat from the RERF for the drying stage of the process, and producing a fibrous output for which Veolia are establishing markets. The PPF is currently being commissioned, but should provide a closed loop on-site for the reprocessing of this material into a saleable product, and also ensuring the recycling of this substantial contributor to the PFI contractual target.
- 2.9 However, all of the problems experienced have meant that it was confirmed in the Annual Report for 2016/17 that Veolia have failed the Annual Key Target for recycling for the 2016/17 contract year, achieving a disappointing 1.3% compared to the contractual guarantee of 10%.
- 2.10 The contract management team have continued to apply the contract consistently throughout in respect of this issue, and it is clear that Veolia are making significant efforts and taking clear measures in terms of changes to operational practices, modifications to the plant and the development of new infrastructure so as to ensure resolution of the issues. Nevertheless, until these issues are resolved and the PPF becomes fully operational, recycling performance will continue to be below the contractual target levels. Given that some of these measures will only take full effect part-way through 2017/18, there is a high risk that this year's performance target will also be missed. However, this report is concerned primarily with addressing the actual performance shortfall relating to 2016/17.

3. Main issues

- 3.1 The RERF contract has a wide range of performance standards to be met by the contractor across all areas of performance, but only three Key Targets, with two relating to landfill diversion and one relating to recycling. The Key Targets have attached to them more significant contractual remedies if not achieved.
- 3.2 In the event of a failure of a Key Target (such as the annual 10% front-end recycling target), the Council is entitled to issue a Performance Warning Notice (PWN). This effectively puts all parties on notice of the material failure, and the issue of two PWNs in any rolling 24 month period gives rise to the right for the Council to terminate the contract.
- 3.3 In light of the recycling performance failure for 2016/17, Veolia have requested that the Council waive its right to issue a PWN, and have offered a financial settlement in return. This relief would give them time to resolve the outstanding issues affecting recycling performance during this year without facing a potential termination scenario at the end of 2017/18 if they were to fall short, even marginally short, of the contractual target.
- 3.4 As noted above, in the view of the Contract Management Team, Veolia are demonstrating their commitment to resolving the issues and have invested significant resources into achieving this. However, it is acknowledged that the proposed measures require more time to implement fully (i.e. replacement of key equipment, commissioning of the PPF, establishment of markets for the fibrous

outputs). The recruitment and training of a third shift for the cleaning and maintenance of the MPT element of the facility is now complete and operational.

- 3.5 The Contract Management Team, in consultation with senior officers and the Executive Member, has therefore negotiated with Veolia in order to reach a satisfactory settlement. Given the importance of recycling performance to the Council and the significance of the PWN as a contractual remedy, the Council has been clear to Veolia that any settlement would need to be commensurate with it waiving its contractual rights in this regard. The details of the financial settlement reached are contained in confidential Appendix 1 of this report. However, the contract management team is satisfied that the settlement is of sufficient value to be considered an appropriate level of compensation in light of the contractual rights being waived.
- 3.6 In addition to this, and irrespective of the proposed financial settlement in lieu of issuing the PWN, a recycling deduction totalling £34,205 is also payable to the Council by Veolia for the shortfall in recycling during the contract year 2016/17.
- 3.7 The Contract Management Team has consulted DERFA's Waste Infrastructure Delivery Programme (WIDP) team on this proposed settlement, who provide the Council's Waste Infrastructure Credits. They have responded formally stating that they do not consider the proposal to be a material variation from Defra's perspective, and that, on this basis, it does not require Defra's approval. WIDP have, however, requested that the Council develop and provide them at the beginning of each financial year with an annual recycling plan which details how the Council will make year-on-year progress towards achieving its recycling targets.
- 3.8 Veolia have also provided an Improvement Plan detailing their plans to resolve the performance issues going forward. These measures are outlined in summary above, but with the key factors being the replacement of the ballistic separators, commissioning of the PPF and introduction of the third cleaning and maintenance staffing shift for the MPT facility.
- 3.9 The settlement will be ring-fenced for the delivery of frontline recycling services, or environmental projects that contribute to recycling.

4. Corporate considerations

4.1 Consultation and engagement

- 4.1.1 Consultation has taken place with the Director of Communities and Environment, the Chief Financial Services Officer, the Director of Resources and Housing, the Chief Officer PPPU and the Executive Member for Environment and Sustainability.

4.2 Equality and diversity / cohesion and integration

- 4.2.1 An equality impact assessment has previously been carried out for the project. The issues covered in this report are predominantly commercial and contractual.

4.3 Council policies and best council plan

- 4.3.1 The RERF is a key part of the infrastructure required to support the Council's environmental and low carbon agenda. The proposals make best use of the Council's contractual position to secure additional funds to be ring-fenced and used as detailed at paragraph 3.9.

4.4 Resources and value for money

- 4.4.1 The financial aspects of this settlement are set out in Appendix 1. It is deemed that the proposed settlement is adequate to reflect the significance of the waiver of the PWN in respect of recycling performance.

4.5 Legal implications, access to information, and call-in

- 4.5.1 This is a Key Decision and is subject to call-in in accordance with the Council's governance procedures.
- 4.5.2 The Executive Commercial Solicitor, PPPU has been involved in the development of these proposals throughout, and has therefore provided the necessary legal advice. In accordance with the comments received from DEFRA as noted above, this is not deemed a material variation to the contract, and the contract already provides that the Council may exercise discretion in relation to the issue of a PWN.
- 4.5.3 Confidential appendix 1 contains commercially sensitive information relating to the financial and business affairs of the Council and Veolia, where the public interest in maintaining the exemption from disclosure at present outweighs the public interest in disclosing the information. This position will be kept under review.

4.6 Risk management

- 4.6.1 Significant risks relating to this project are included within the Communities and Environment directorate risk register. Project specific risks are logged and reported to Environment Programme Board and Waste Programme Board.
- 4.6.2 The proposals set out within this report entail securing service improvements, together with a financial settlement in lieu of contractual measures which would move Veolia towards a potential contract termination scenario. In this sense they represent a mitigation of the risks associated with this scenario and the application of the default contractual position relating to this Key Target and performance failure.

5. Conclusions

- 5.1 Despite Veolia's ongoing efforts to resolve the issues impacting on recycling performance, the Key Target for recycling has been failed for 2016/17. At Veolia's instigation the Council entered negotiations with a view to delivering a financial settlement in lieu of issuing a PWN.
- 5.2 Due to the complexity and nature of the actions required to resolve the mechanical problems encountered within the facility and the problems in securing markets for some materials, not all the measures have yet been fully implemented.
- 5.3 The Council's Contract Management Team is currently satisfied that Veolia is committed, and has already implemented substantial measures as outlined above, to address the recycling performance issues. The team is therefore supportive of providing Veolia with some measure of relief and additional time to rectify the remaining issues through the waiver of a Performance Warning Notice for 2016/17, and in return for a commensurate financial settlement.

- 5.4 However, should Veolia fail to achieve the recycling target for 2017/18, the Council will again be in a position to issue a PWN. Performance and progress against Veolia's own Improvement Plan will be monitored closely by the Contract Management Team to ensure that the proposed measures are being implemented and that issues are being resolved so as to enable the contractual target to be achieved.
- 5.5 It is considered that, while the financial offer detailed in confidential Appendix 1 of this report may not put the Council in the position it would have been in had Veolia fully performed its contractual obligations, it is significant, and as such may be considered appropriate compensation for the breach in exchange for waiving the PWN.
- 5.6 The financial settlement will be ring-fenced for the delivery of frontline recycling services, or environmental projects that contribute to recycling.
- 5.7 This proposal represents a variation from the contract and a Council key decision given its significance. The proposed variation has now been approved by DEFRA's Waste Infrastructure Delivery Programme, and Chief Officer approval is now sought to approve and implement this variation under the relevant delegations.

6. Recommendations

- 6.1 The Chief Waste Management Officer is recommended to:
- c) note the contents of this report;
 - d) approve and implement the proposed contract variation to accept Veolia's financial settlement detailed within confidential Appendix 1, in return for the waiver of the issue of a Performance Warning Notice in relation to Veolia's failure to meet the Annual Key Target for recycling for 2016/17 under the Residual Waste Treatment PFI Contract.

7. Background documents¹

- 7.1 Appendix 1 – confidential information providing details of financial settlement.

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.