

Settlement Agreement relating to Leisure PFI Projects

Date: 27th February 2024

Report of: Area Manager Active Leeds

Report to: Chief Officer Operations & Active Leeds

Will the decision be open for call in? Yes No

Does the report contain confidential or exempt information? Yes No

Brief summary

This report is to gain approval for the Council to enter into two Settlement Agreements, one with each of the respective providers under the BSF3 Leisure PFI (relating to Armley and Morley Leisure Centres) and the BSF4 Leisure PFI (relating to the Holt Park Well Being Centre) projects (the “**Projects**”).

A sustained period of substandard performance at the leisure facilities under the Projects has resulted in unavailability and service performance issues, and given rise to various disputes between the parties (the **Disputes**). The Settlement Agreements are to be entered into in resolution of the Disputes.

Under the terms of the Settlement Agreements:

- The Council will release £4,414,693.41 excluding VAT of held deductions to the Contractor (the “Settlement Amount”)
- The Council will retain £1,744,443.91 of deductions withheld in respect of the Projects (the “**Settlement Retention**”);
- The Council will allow a moratorium providing the ProjectCos with an opportunity to rectify the issues whilst receiving appropriate relief from their contractual obligations under BSF3 Leisure PFI and BSF4 Leisure PFI in order to facilitate such rectification;
- the ProjectCos will, at their cost, appoint an independent surveyor (the “**Consultant**”) to undertake a survey of the three leisure centres and produce a report identifying the rectification works required to achieve the contract standards;
- the ProjectCos will then have a 14 month period to agree with the Council a rectification programme and undertake the rectification works, following which the moratorium period will end;
- during the moratorium period, the Council will receive c£180k from the ProjectCos to cover resourcing costs of the Council relating to oversight and monitoring of the rectification.

Recommendations

The Chief Officer Operations & Active Leeds is recommended to:

- a) Note the content of this report;
- b) Note the terms of the settlement of various disputes relating to performance issues under the Projects;
- c) Approve entering into:
 - a settlement agreement between Leeds City Council and Environments for Learning Leeds PFI Three Limited in respect of the Armley Leisure Centre and Morley Leisure Centre; and
 - a settlement agreement between Leeds City Council and Environments for Learning Leeds PFI Four Limited in respect of the Holt Park Wellbeing Centre,(together the “**Settlement Agreements**”); and
- d) Approve entering into all other ancillary documents and taking such other action required to facilitate resolution of the Disputes.

What is this report about?

- 1 The Council entered into PFI project agreements in relation to Armley Leisure Centre and Morley Leisure Centre (BSF3, in August 2008) and the Holt Park Wellbeing Centre (BSF4, December 2011). The Council’s counterparties under these Projects (the “**ProjectCos**”) subsequently entered into building and facilities management sub-contracts with Tilbury Douglas Construction Ltd (previously Interserve Construction Project Services Ltd) who in turn entered into a sub-contracts with Mitie FM Ltd (previously Interserve (Facilities Management) Ltd). Under these arrangements Mitie FM Ltd provide property maintenance, grounds and horticulture maintenance, cleaning, waste management and pest control, security and health and safety services, reactive services and asset management at the leisure centres.
- 2 In light of recent and ongoing operational and performance issues, the Council has withheld substantial amounts from the service payments otherwise made to the ProjectCos using the contractual mechanisms set out in the Project Agreements.
- 3 While the fact of underperformance is not disputed, the contractual remedy available to the Council and the necessary remedial works/actions was disputed by the ProjectCos. As required by the contracts, the Council has been consulted with the ProjectCos in good faith in an attempt to come to an agreement in relation to the Disputes. As a consequence of this consultation, the Settlement Amount in relation to service payments withheld and a process for determining the required rectification work and other remedial actions required to rectify the poor performance have been agreed by the parties. The exact requirements of these remedial works will be detailed and agreed following surveys to be carried out by the Consultant. They will be carried out at the ProjectCos’ cost.
- 4 To facilitate these remedial works, the Council has agreed a moratorium on further deductions in relation to items identified in the surveys, and will also release a proportion of the withheld monies.

- 5 The parties have agreed to enter into a Settlement Agreement for the purposes of setting out the terms for a full and final settlement of all rights and liabilities relating to the Disputes, and to set out the terms upon which the ProjectCos will correct the unavailability and performance issues experienced across the three sites, and to confirm the financial settlement.
- 6 This report outlines the obligations, implications, timescales and risks associated with the Settlement Agreement.

What impact will this proposal have?

- 7 Since early 2022, there have been a number of instances of substandard performance in relation to the Projects giving rise to unavailability, performance failures and breaches of contract across the BSF3 and BSF4 sites. While some remedial interventions have been made, under performance has continued. Examples of these failures are summarised below:
 - a) Health and Safety concerns including in relation to operation of pool plant rooms;
 - b) Swimming pool halls humidity levels;
 - c) Poor ventilation across the leisure centres;
 - d) Pool closures due to chemical imbalances;
 - e) Helpdesk reporting issues including the premature closure of unresolved issues;
 - f) Poor cleaning;
 - g) No lifecycle work undertaken during the period 2022-23 with some tasks now two years overdue.
- 8 This proposal recommends the Council enter into two Settlement Agreements with the ProjectCos – one for BSF3 and one for BSF4. Under the terms of the Settlement Agreements, the parties will settle the Disputes (including in relation to the Council's financial remedy for under-performance). In order to facilitate rectification of the various issues, the Council will enter into a moratorium providing the ProjectCos with relief from further performance deductions while the Consultant undertakes a survey of the three leisure centres and produces a report identifying the rectification works required to achieve the contract standards, and thereafter for a 14 month period while the ProjectCos agree with the Council a rectification programme and undertake the rectification works, following which the moratorium period will end.
- 9 The Council may apply its contractual remedies (including deductions) relating to issues unrelated to those matters relating to the Disputes or identified in the surveys (referred to as "**new issues**").
- 10 The ProjectCos are appointing AtkinsRéalis PPS Ltd as Consultant to undertake the technical surveys for the three sites to establish the extent to which the buildings fail to meet availability and service standards as specified in the contracts. The output is a "Rectification Works Report" providing a prioritised schedule of rectification works including any works identified as urgent.
- 11 The ProjectCos will act as Client for the Consultant appointment, however the terms of the appointment and scope of survey have been agreed with the Council and collateral warranties for both Projects will be put in place for the benefit of the Council. It is anticipated that the Consultant will produce the Rectification Works Report within 14 weeks of appointment, following which the ProjectCos and the Council will agree a rectification programme and the ProjectCos will undertake the rectification works.

- 12 The Settlement Agreement, the Consultant appointment and collateral warranties are attached as confidential appendices due to the sensitive commercial content of the documents. They will be completed simultaneously.
- 13 Under the terms of the Settlement Agreement, the ProjectCos is obliged to submit a number of “Service Improvement Plans” to the Council outlining proposals for how future service delivery will comply with contractual requirements.
- 14 With regards management and governance of the rectification programme, a monthly Settlement Liaison Group will be formed providing a joint forum for early resolution of issues. A Joint Steering Group will also be formed providing a joint executive level decision-making forum. This forum will meet monthly and consider issues which have been escalated by the Settlement Liaison Group.

How does this proposal impact the three pillars of the Best City Ambition?

- Health and Wellbeing Inclusive Growth Zero Carbon

- 15 The safe and effective operation of the Council’s leisure and wellbeing centres is of key importance in promoting Health and Wellbeing and delivering against the Best City Ambition. By supporting healthy, active lifestyles, people of all ages can fully realise their social, educational and economic potential.
- 16 The centres at Armley, Morley and Holt Park provide an opportunity for the Council to work collaboratively with partner organisations, enabling communities to access leisure facilities to promote health and wellbeing. It is anticipated that this proposal will address issues of unavailability with the centres and address substandard service performance.

What consultation and engagement has taken place?

Wards affected: Adel & Wharfedale, Armley, Morley South		
Have ward members been consulted?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No

- 17 The Executive Member for Adult Social Care, Public Health and Active Lifestyles has been consulted as part of the proposals.
- 18 The Director City Development has been consulted as part of the proposals.
- 19 Representatives of Department of Health and Social Care and the Infrastructure and Projects Authority have been consulted throughout in respect of both the underperformance and the settlement proposals.
- 20 External advice and support has been received from Integer Advisory Services (technical/contract support) and Weightmans LLP (legal).

What are the resource implications?

- 21 There is a resource commitment for the Council arising from the Settlement Agreements in terms of engaging with the Consultant, inputting into and agreeing the rectification programme, assessing the effectiveness of remedial works and attending periodic partnership meetings. Under the terms of the Settlement Agreements, the ProjectCos is liable for the Council’s monthly administrative costs from the date of the Settlement Agreements until the earlier of (i) completion

of all Rectification Works and (ii) the end of the Delivery Period (with a pro-rata amount payable in relation to any part months) anticipated to total c£180k over the period.

- 22 Under the terms of the Settlement Agreement, the Council will have 10 business days to comment on the draft Service Improvement Plans and 15 business days to comment on the draft rectification programme.
- 23 The Council has been responsible for plant room operations since 31st July 2023. It is anticipated that this will continue throughout the moratorium period, though it may end earlier if the Council agrees. The ProjectCos shall be liable for the Council's cost for delivery of the Plant Room Operations (up to a maximum of £10,000 plus VAT - £6,500 for BSF3 and £3,500 for BSF4) plus any reasonable additional costs (e.g. purchase and transfer of chemicals). This will be deducted from the subsequent invoice due post completion of the Settlement Agreement hence excluded from the Settlement Retention.
- 24 Management of the performance issues and negotiation of the Settlement Agreements and this settlement has required considerable resourcing from the Council from Active Leeds, City Development and the Procurement and Commercial Services. It has also required external legal consultancy through Weightmans LLP and external technical / contract support from Integer Advisory Services which costs will be met from the Settlement Retention.
- 25 The Council will retain the Settlement Retention.
- 26 The ProjectCos are liable for the cost of the independent survey plus the cost of any rectification works identified as part of the survey.

What are the key risks and how are they being managed?

- 27 As a result of the Settlement Agreements the Council waives its remedies against ProjectCos for unsatisfactory performance relating to known issues during the moratorium period described above. It is recognised that this is not an ideal scenario for the Council, however it is anticipated that the rectification programme will address unavailability and performance issues over the period, with those deemed urgent being addressed as a priority.
- 28 The Consultant was unagreeable to entering into a joint appointment including the Council as well. As such the ProjectCos are client to the Consultant appointments. There is a risk that the ProjectCos can instruct the Consultant directly. This has been mitigated through Collateral Warranties for all parties and a protocol within the Settlement Agreement which includes that any instructions may only be made with the knowledge and consent of the Council, and the Council must be copied into correspondence.
- 29 There is a risk that the rectification programme interfere with operation delivery across the sites. The Settlement Agreement states that the Council has 15 days on receipt of the draft programme to review against planned service provision and comment accordingly, including objecting if the programme interferes with operations and such interference could be avoided or mitigated by the rescheduling the works. In the event that the parties are unable to agree a rectification programme, the matter may be escalated to the Joint Steering Group for consideration and, where circumstances require, an independent adjudicator for resolution. There is a change mechanism prescribed in the Settlement Agreements should circumstances necessitate changes to the programme.

30 This Settlement Agreement resolves the risk that the parties may end up in a protracted dispute (together with attendant significant cost consequences and further protracted under-performance) and facilitates the most prompt resolution of the under-performance.

What are the legal implications?

31 This report is seeking approval from the Chief Officer Operations & Active Leeds pursuant to her delegated authority in relation to sport and active Leeds. As per section 2(b) (pg 31) of the sub-delegation scheme of Director of City Development. This decision is a significant operational decision in accordance with Article 13.5.1(b) (being in relation to settlement of proceedings).

32 The Council will enter into two separate Settlement Agreements with the ProjectCos – one for BSF3, and one for BSF4. These will be fundamentally identical agreements. These agreements entitle the Council to permanently retain the Settlement Retention in relation to the under-performance, in full and final settlement of the Disputes.

33 Under the terms of the Settlement Agreements, the Council will enter into a moratorium providing the ProjectCos with relief from further performance deductions while the Consultant undertakes a survey of the three leisure centres and produces a report identifying the rectification works required to achieve the contract standards, and thereafter for a 14 month period while the ProjectCos agree with the Council a rectification programme and undertake the rectification works, following which the moratorium period will end. During the moratorium the Council may apply its contractual remedies (including deductions) in relation to new issues.

34 The Council will benefit from two separate collateral warranty agreements with the Consultant in relation to the surveyor appointment – one for BSF3 and one for BSF4.

35 In accordance with Access to Information Rule 10.4(3), the Appendices to this report contain commercially sensitive information relating to the financial and business affairs of the Council and the various other related parties referred to in this report, 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.

Options, timescales and measuring success

What other options were considered?

36 Do nothing – one option would be to not progress a Settlement Agreement and continue making performance deductions from the ProjectCos should availability or standards not be met. This was discounted on the basis this approach does not address the issues which are impacting on the availability of the asset and user experience and the Council is keen to ensure services are provided as specified. In addition, this would most likely escalate to a formal court or termination claim on the part of the ProjectCos. While the Council is confident of its position in terms of actions taken, the Council would in this instance be subject to litigation risk.

37 Termination – one option would be to pursue termination of the PFI contract with the ProjectCos. This was discounted on the basis that termination would be complex, lengthy and costly, and may further impact on service provision. This approach would not necessarily resolve the issues and the ProjectCos have demonstrated a willingness to work collaboratively to implement a resolution, which is anticipated to be the most prompt route to rectification.

How will success be measured?

38 Success will be measured through compliance with contractual requirements in relation to availability and service performance standards. There may be additional anecdotal measures such as customer feedback.

What is the timetable and who will be responsible for implementation?

39 The following charts the indicative timetable for delivery:

Activity	Date
Settlement agreement – Executed Document	Wednesday 28 th February 2024
Receipt of Final Rectification Works Report from Consultant	BSF 3 (Armley) – 13 th May 2024 BSF 3 (Morley) – 29 th April 2024 BSF 4 (Holt Park) – 12 th April 2024
Receipt of rectification programme from ProjectCos	BSF 3 (Armley) – 28 th May 2024 BSF 3 (Morley) – 15 th May 2024 BSF 4 (Holt Park) – 29 th April 2024
Completion of rectification works and end of Delivery Period	BSF 3 (Armley) – 13th July 2025 BSF 3 (Morley) – 29th June 2025 BSF 4 (Holt Park) – 12th June 2025

Appendices

- CONFIDENTIAL: Appendix A – Settlement Agreement (BSF 3)
- CONFIDENTIAL: Appendix B – Settlement Agreement (BSF 4)
- CONFIDENTIAL: Appendix C - Surveyor Appointment (BSF 3)
- CONFIDENTIAL: Appendix D - Surveyor Appointment (BSF 4)
- CONFIDENTIAL: Appendix E – Collateral Warranty (BSF 3)
- CONFIDENTIAL: Appendix F – Collateral Warranty (BSF 4)

Background papers

- None