

CABINET – 27 JULY 2010

OXFORDSHIRE RESIDUAL WASTE TREATMENT PROCUREMENT – AWARD OF CONTRACT

Report by Director for Environment & Economy and Assistant Chief Executive
& Chief Finance Officer

Introduction

1. Oxfordshire County Council has been procuring a residual waste treatment contract to divert waste away from landfill in accordance with the Oxfordshire Joint Municipal Waste Management Strategy. In March 2007 the contract was advertised in the Official Journal of the European Union (OJEU). On 7 September 2009 the Cabinet agreed the selection of Viridor as preferred bidder, and since then a process of clarifying and confirming commitments in the contract has been ongoing. The purpose of this report is to explain the nature of the contract and its financial implications including the allocation of risk between the council and the contractor, and to recommend the award of the contract to Viridor.

Exempt Information

2. This report contains information in Annexes 2, 3 and 4 that relates to a contract tender process in progress and is commercially sensitive. The public should therefore be excluded during consideration of Annexes 2, 3 and 4 because its discussion in public would be likely to lead to the disclosure to members of the public present of information in the following category prescribed by Part I of Schedule 12A to the Local Government Act 1972 (as amended): category 3 - Information relating to the financial or business affairs of any particular person (including the authority holding that information); and since it is considered that, in all the circumstances of the case, the public interest in maintaining the exemption outweighs the public interest in disclosing the information, in that disclosure would distort the proper process of open competition and would prejudice the position of the authority in the process of the transaction and the council's standing generally in relation to such transactions in future, to the detriment of the Council's ability properly to discharge its fiduciary and other duties as a public authority.

Background

Context

3. Annex 1 explains the drivers for the project and sets out the procurement process which has progressed from advertisement of the contract in March 2007, through the competitive dialogue process under the Public Contracts Regulations 2006. The procurement has been shaped from the outset by the

Oxfordshire Joint Municipal Waste Management Strategy. This is a proactive strategy which looks at the whole municipal waste stream and has the waste hierarchy at its core. The county council and the district councils are delivering new collection services and waste infrastructure that is increasing recycling and composting and helping to reduce the amount of waste going to landfill. Oxfordshire achieved a recycling and composting rate of 48.75% in 2009/10 and on current data this places Oxfordshire in the top quartile of waste disposal authorities for waste recycling and composting performance.

4. The strategy also acknowledges there will be residual waste remaining and that value needs to be recovered from residual waste rather than sending it to landfill. Recovering value from residual waste moves it up the waste hierarchy from disposal to recovery and will achieve sending virtually zero waste direct to landfill.

Waste tonnage requirements

5. The council as Waste Disposal Authority (WDA) has a statutory responsibility to dispose of the residual waste collected by the district councils under their statutory duties as Waste Collection Authorities. In 2009/10 Oxfordshire produced over 310,000 tonnes of municipal waste of which over 165,000 tonnes was disposed of to landfill. The drivers for diverting this waste away from landfill and securing a contract to treat and recover value from residual waste are set out in annex 1.
6. In the recent past there has been a reduction in waste arisings nationally. The county council has seen a reduction in household waste arisings of approximately 10% over 2 years. Whilst some of this reduction is thought to be due to waste reduction initiatives it is also likely that it is largely due to the recent recession. When the recession is over it could be that there will be a reversal of this recent trend and a resumption of historic trends of increasing waste arisings. While the joint waste strategy sets a challenging target to stop waste growth per person by 2012, over 55,000 homes are planned to be built in Oxfordshire between 2006 and 2026 and allowance needs to be made to manage this new source of municipal waste. It is anticipated between 130,000 and 160,000 tonnes of residual municipal waste will require treatment and be sent to the energy recovery facility to be provided under the contract.

Progress since preferred bidder selection

7. In September 2009 the Cabinet agreed the selection of Viridor as preferred bidder. Since September 2009 the project team have been clarifying and confirming commitments in the final tender submitted by Viridor.
8. The key issues that have required confirmation and clarification are described in annex 2 (exempt). The process included resolving the consequences of both the refusal of planning permission for the Ardley EfW by Planning and Regulation Committee in October 2009, and the publication by the council of revised lower forecast municipal waste tonnages than it had predicted before the call for final tenders (CFT).

Key features of the contract

9. Technical solution – under the contract Viridor will provide a 300,000 tpa energy recovery facility at Ardley. As set out in paragraph 6 above, the facility is expected to treat between 130,000 and 160,000 tonnes of the council’s residual municipal waste per year over the life of the contract. Viridor will use the remaining capacity to treat commercial and industrial (C&I) waste which will enable some of Oxfordshire’s C&I waste to be treated. The facility will divert from landfill at least 95% of residual MSW received and will generate 22MW net of electricity, sufficient for at least 22,000 homes. The facility will be combined heat and power (CHP) enabled allowing future heat off take should suitable end users be identified.
10. The outputs from the process are summarised in table 1 below.

Table 1 Outputs from the EfW facility

EfW facility outputs	Quantity and use/destination
Electricity	22 MW net for sale to the national grid
Metals	2% by weight of contract waste input. Will be sold for recycling
Incinerator bottom ash (IBA)	24% by weight of the contract waste input. 86% of this will be recycled
Air pollution control (APC) residues	3.6% by weight of the contract waste input. To be disposed in hazardous waste landfill.

11. Programme – Viridor’s current programme indicates that the detailed design, construction, and commissioning of the facility will take 38.5 months. This currently means that if planning permission is granted early in 2011 following the appeal, the facility will become fully operational in May 2014 following commissioning.
12. Principles of the contract – the main features of the contract are set out in table 2 below.

Table 2 Contract main features

Contract principles	Commentary
Contract term	The contract will cover the works period while the facility is being built and commissioned and a 25 year service period from the date that the treatment service starts. The contract also includes an option to extend of up to 10 years.
Funding, contract structure and guarantees	The capital investment will be fully corporately funded by the Pennon Group, with funding provided in as both senior and subordinated debt. The contract will be between the council and a special purpose vehicle (SPV) that Viridor will set up specifically to build and

	<p>operate the facility. The contract will ensure that the SPV will have appropriate support from Viridor Ltd in the form of a parent company guarantee.</p> <p>The SPV will have two main sub-contracts; an EPC sub contract with a joint venture set up by the technology and civil engineering providers (CNIM and Clugston) to build the facility, and an operations and maintenance (O&M) contract with Viridor Waste Management Limited to run the facility. The project team is undertaking appropriate due diligence on the sub-contracts to ensure the arrangements are robust.</p>
Asset ownership	<p>During the dialogue stage of the procurement options were explored for the facility to revert to the council on expiry or earlier termination and for the facility to remain with the SPV. As part of the process of confirming and clarifying commitments, it has been agreed that the asset will now be retained by Viridor on expiry or earlier termination. This is advantageous to the council as it reduces potential liabilities for the council on termination for contractor default and for force majeure termination. The council will also have no residual liabilities for the asset when the waste treatment service period eventually ends.</p>
Authority requirements and performance management	<p>The contract specifies the requirements of the service for treating municipal residual waste and how the contractor's performance will be measured using a performance measurement framework (PMF). Failure to achieve standards in the PMF will result in deductions from the unitary charge levied under the payment mechanism, and therefore incentivises the contractor to achieve good performance.</p>
Waste acceptance protocol (WAP)	<p>While the facility will be designed to treat residual municipal waste collected from the kerbside by the WCAs and from the waste recycling centres, there are some types of waste that are not suitable for treatment. The WAP sets out what these are e.g. plasterboard, mattresses and tyres, and the protocol for dealing with excluded materials and contaminated loads should they be delivered. The WAP has been developed in liaison with the WCAs through the OWP.</p>
Contract waste	<p>Viridor will have exclusive rights to receive all Oxfordshire's residual municipal waste that can be treated in the facility. Breach of this obligation will require the council to compensate the contractor so it is in a "no better no worse" situation as a result of the breach. In order to ensure that the council meets this obligation agreements with each of the WCAs to deliver residual waste have been developed through the OWP. Agreements are expected to be signed by</p>

	<p>all the district councils by the time of the Cabinet meeting. Additionally as Waste Disposal Authority the county council has the legal power to direct Waste Collection Authorities.</p> <p>The commitment to deliver all residual waste will not prevent continuing work to reduce waste and to further increase re-use, recycling and composting.</p> <p>The contract details the current baseline for the waste materials collected by the WCAs which is in line with the Oxfordshire Joint Municipal Waste Management Strategy. Under the contract any departure from the baseline could be dealt with as an authority change. The district councils as WCAs have confirmed they are in agreement with this position, and it will not affect continuing campaign work to encourage waste reduction, recycling and composting.</p>
<p>Payment mechanism</p>	<p>The basis for payment is a monthly unitary charge which is then adjusted using a formula set out in the payment mechanism. Adjustments include deductions for performance failures, failure to achieve the contracted diversion rates and non acceptance of waste.</p> <p>The payment mechanism will provide a share of excess third party income, such as from electricity generated and sold and gate fees from commercial and industrial waste processed. It will also provide a share of excess profit generated through cost reductions achieved throughout the contract period.</p> <p>The payment mechanism operates on the basis of exclusivity and not through guaranteeing a minimum tonnage. Further details about the payment mechanism are in annex 3 (exempt).</p>
<p>Variations to the contract</p>	<p>The contract includes a protocol for dealing with requests to change the contract from either party. OCC would be liable for any additional costs arising from a change it requests.</p>
<p>Changes in legislation</p>	<p>A qualifying law is generally a change in law which is not foreseen at the date of the contract and can be;</p> <ul style="list-style-type: none"> • Specific to the contract and/or the contractor • Specific to the provision of the works and/or services or relates to emissions, generation of power or the permitting of the facility • In respect of the council's best value duties. <p>The council will take the risk of costs associated with any change because the change would not otherwise</p>

	<p>affect the contractor if it were not for the contract being in place. This is in accordance with standard practice.</p> <p>Additionally the contract includes a foreseeable change in law list which takes into account new laws which can be foreseen at the date of the contract but which cannot be priced. The council also accepts risk on those changes being implemented.</p>
<p>Insurance</p>	<p>The contract specifies that the contractor takes out and maintains certain insurances. If at any time during the contract term insurance becomes unavailable, the council may become insurer of last resort if the council wishes the facility to continue to operate and provide the service. This is a standard provision in major waste infrastructure contracts.</p>
<p>Planning and permit risk</p>	<p>The contract includes a schedule which sets out a protocol and provisions should the applications for planning permission or the environmental permit fail. A contingency has been included in the contractor's financial model for meeting the costs of an appeal.</p> <p>If planning permission is successfully achieved but has conditions attached that are unsatisfactory or require architectural enhancements the council would be liable to meet the additional costs of these.</p> <p>If the contractor is unable to secure a satisfactory planning permission the contract allows for consideration of a revised project plan or force majeure termination for which a capped amount of compensation would be payable by the council.</p> <p>The environmental permit application has been progressed by the Environment Agency. At the end of June the Agency published the draft permit and decision notice confirming that they are minded to approve the application.</p>
<p>Default and termination</p>	<p>The contract sets out the circumstances where either party would be in breach of the contract. The council would be in default through failure to pay for the service or breach of its obligations under the contract. The contractor would be in default through breach of a number of provisions in the contract including failure to start the service by the longstop date for service commencement, failure to process waste by energy recovery for an agreed period, non-acceptance of waste for longer than specified periods of time, and various other breaches of the contractor's obligations.</p>

	<p>The compensation payable for authority default, contractor default or force majeure termination varies according to the circumstances and the method of calculating the amount is set out in the contract.</p> <p>The council may voluntarily terminate the contract. However, this would involve significant compensation which would be calculated according to the contract.</p>
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13. Relationship with the WCAs – as referred to in table 2 above, it is important that the district councils as WCAs deliver the residual waste they collect to the facility (directly or via a transfer station) in order for the council to meet the exclusivity obligations in the contract. In order for the facility to operate efficiently the WCAs will also need to comply with the waste acceptance protocol and site operational requirements. The WCAs are all expected to have signed agreements with the council as WDA by the time of the Cabinet meeting confirming they will deliver their residual waste to the facility and comply with site instructions issued by the contractor. The agreements are similar to those for the food waste treatment contract.

Analysis of the contract position

Risk transfer

14. Throughout the procurement process the principle has been adopted that risks should be taken by the party best able to manage them. The allocation of risks between OCC and the contractor is set out in detail in annex 4 (exempt). In agreeing the share of risk with the contractor the starting point has been HM Treasury’s Standardisation of PFI Contracts version 4 (SoPC4) and the derogations approved by Defra for waste projects.
15. OCC is accepting appropriate risks and the costs associated with these. These include if the council changes the specification, changes in design or external appearance through conditions attached to the planning permission, and failure to deliver waste and breach of exclusivity. The unitary charge is subject to indexation. The approach to mitigation of foreign exchange risk is discussed in annex 3 (exempt).
16. The contractor will be taking the risks associated with the design and construction of the facility and any latent defects. As the contractor will retain ownership of the facility they will also retain liability for decontamination and disposal of the facility at the end of the contract. During the operation of the facility the contractor will take the risk of changes in waste composition resulting from consumer behaviour, changes in calorific value, failure to meet performance standards and non-availability of the facility.
17. A number of risks will be shared between OCC and the contractor. The risk of variations in third party income is shared in that Viridor have guaranteed a certain level of third party income generation which is their risk. However, any variations (higher or lower) will affect OCC’s share of income generated

above the guaranteed amount. The costs of changes in legislation are the council's risk.

18. In relation to planning risk the cost of obtaining consents including the application process and appeal is met by the contractor and included in the financial model. If the actual costs are below an agreed figure, the difference is returned to the council. Any costs associated with unsatisfactory planning conditions or architectural enhancements required by the planning permission will be met by the council and could affect the unitary charge. The potential financial implications of planning risks are considered in annex 3 (exempt).
19. The project team considers that the allocation of risk as described above and in more detail in annex 4 (exempt) is appropriate given the proportion of the capacity of the facility to be utilised by Oxfordshire's residual municipal waste, the retention of ownership of the facility by Viridor on expiry or earlier termination of the contract, and the balance between risk and overall price.

Value for money

20. In order to select Viridor as preferred bidder, a value for money assessment was undertaken to compare the final tenders submitted against a value for money (VfM) benchmark of a "do nothing" base case of the costs of continuing to dispose of residual waste to landfill. The assessment included all costs associated with the treatment solution and continuing to landfill waste, including the cost of landfill, landfill tax, LATs, haulage and transfer. This assessment has been repeated and is set out in detail in annex 3 (exempt). This VfM assessment has demonstrated that the proposed Viridor contract represents value for money to the council.
21. In addition, in order to try to reflect the respective risks and potential for changes to costs and income, a number of sensitivities were run on both the cost of Viridor's bid and also the do nothing case to provide a range of potential costs under each of the scenarios. The sensitivities were performed on the following factors:
 - (a) Increases in landfill tax;
 - (b) Increases in the forecast level of third party waste gate fees and electricity income;
 - (c) Delay in planning determination; and
 - (d) Increase and decrease in the foreign exchange rate.
22. The sensitivity assessment demonstrates that taking into account the potential risks associated with each scenario, the contract with Viridor still represents value for money. Further detail of the sensitivities run is included in annex 3 (exempt).
23. In relation to funding of the Viridor bid, it has been confirmed that funding is available for this project and that the terms as proposed at CFT have been held and will be held under the terms agreed with the council.

24. The project team has looked at how the contract compares with the market. On the basis of a high level comparison across other deals currently under procurement, the Oxfordshire contract gate fee and payment mechanism items compare favourably with other UK PPP/PFI waste contracts, further detail of which is included in annex 3 (exempt).

Contract close options

25. A key question for the Cabinet in reaching a decision to award contract is whether to close the contract in advance of the decision on planning permission being known. It is usual for PFI/PPP waste contracts to be closed before planning consent is secured and the Defra model contract includes drafting to inform an appropriate risk share between authorities and contractors in relation to planning risk. This provides certainty of the terms and conditions of the contract, certainty of the funding and the terms of that funding, and fixes the costs of capital expenditure subject to agreed indexation. If planning is ultimately unsuccessful and the contract is terminated, OCC would be liable to pay a capped sum in compensation, but these costs though significant would be relatively limited as construction would not have started.
26. In comparison, if contract close were delayed, the council would not have certainty about key costs including increases in funding costs and/or sub-contractors increasing prices. Even a small increase in the lending rate could make the contract unaffordable in terms of value for money. Increased costs would be payable over the life of the contract, which may be a significant amount compared to the costs of termination. These factors are discussed in more detail in annex 3 exempt.
27. The public inquiry for Viridor's appeal against Planning and Regulation Committee's refusal of their planning application was held this month. Viridor took the necessary steps to prepare and present a robust case. Leading counsel, instructed by Viridor, has indicated that there is a reasonable chance of a successful outcome. However, this and the outcome of the application resubmitted by Viridor recently cannot be predicted and the council needs to be mindful that, in accordance with the agreed risk allocation in the contract, there are risks associated with planning failure or unsatisfactory planning conditions as outlined above.
28. In conclusion, the project team considers that the contract provides value for money now and compares well against other similar procurements. There are significant risks and uncertainties associated with delaying contract close which are considered to outweigh the cost of termination should planning permission not be achieved. Therefore the project team consider that the contract should be closed as soon as it is feasible.
29. There are limited options if the contract is not awarded. It is likely that a new procurement would be launched which would take 3-5 years to complete and cost in the region of £3m, with follow on delays to facilities becoming

operational and the consequential costs of landfill, LATs and landfill tax in the meantime.

30. It is likely that the cost of land filling will increase significantly as landfill tax replaces LATS as the primary driver to divert waste from landfill in the next few years. Every £8 increase in the landfill tax escalator equates to just over £1m unbudgeted annual pressure. Securing a new contract could also be significantly more expensive to the council and as landfill cost increase the VfM position also increases allowing for costs to significantly escalate whilst still remaining VfM. All cost increases will be unbudgeted for and an additional cost burden to the council.

Environmental considerations

31. The environmental benefits which entering into the contract should achieve have been discussed in previous reports to Cabinet. Of particular significance is that together with the continuing improvements in recycling and composting performance, and investment in new infrastructure and collection services, the level of diversion that this contract will deliver will achieve virtually zero waste direct to landfill. It will move waste up the waste hierarchy from disposal to recovery, implementing the Oxfordshire joint waste strategy.
32. Recovering energy from waste supports the low carbon agenda and Viridor's facility will be classified as a waste treatment facility under the Waste Framework Directive, which means it will be recognised as a recovery rather than disposal facility. The council's own analysis using WRATE (Waste and Resources Assessment Tool for the Environment) demonstrated that technologies that produce electricity perform well in terms of global warming potential compared to other technologies.
33. It has been reported previously that energy from waste technology is widely and safely used in many European countries and is increasingly being used in the UK. The Environment Agency will strictly regulate the operation of the facility and Viridor will require an environmental permit which will specify amongst other things the requirements for monitoring emissions from the facility. The Environment Agency have recently published for consultation the draft environmental permit for the Ardley facility and stated that they are minded to approve the application. In reaching their conclusions the Environment Agency have taken into account the views of the Primary Care Trust who have considered the implications of the facility for health.

Conclusion

34. There is a clear and strong need to divert waste from landfill in relation to environmental and financial drivers, as expressed in legislation and Government and local waste strategy. These drivers have been set out in previous reports to Cabinet and also here in annex 1. They remain unchanged and in some respects have strengthened with the increase in landfill tax which will help to encourage the diversion of commercial waste from landfill as well as municipal waste.

35. A residual waste treatment facility of the scale of the energy recovery facility that will be delivered through this contract is essential to provide a waste treatment service that meets stringent value for money benchmarks while meeting environmental drivers. The value for money assessment has been undertaken prudently and has taken into account appropriate sensitivities, and has demonstrated that the tender is value for money. The project team have looked at the balance between risk share and price and concluded that this is appropriate.
36. Overall, the project team external advisors who include Defra, Entec, Ernst & Young LLP, and Trowers & Hamblins LLP have confirmed from their respective professional expertise that the proposed contract award offers both sound technical and business sense, and is competitive with current offers elsewhere in the U.K. The procurement process has secured a partner in Viridor that has the financial and operational capacity to deliver a service of quality and commercial viability. I agree with the conclusions of the project team that it is more advantageous, despite the risks and cost implications if planning permission is not successfully secured, to proceed to award the contract and achieve contract and financial close as soon as possible.

Local Government (Contracts) Act 1997 Certificate

37. It is a requirement of the contract that a certificate under the Local Government (Contracts) Act 1997 be delivered to Viridor. The Act was passed in order to overcome PFI lenders' fears that contracts entered into by a local authority could subsequently be ruled "Ultra Vires" or outside the powers of that local authority leaving the lenders and counterparty without any remedy for any losses they might suffer as a result. The Act provides a procedure for local authorities to certify that they have the authority to enter into a contract and for the counterparty and any funders of that counterparty (in this case, Viridor) to rely on the certificate. The effect of the certificate is that in the unlikely event that the court were to set aside the contract on the basis that it was outside the local authority's powers, then this is treated as an authority default giving rise to an obligation on the part of the authority to pay compensation

Next steps

38. Following the Cabinet's decision and completion of the scrutiny process, the contract award notice will be published in accordance with the Public Contracts Regulations 2006 and will be followed by a ten day period stand still period before the contract can be signed. Unsuccessful bidders will be entitled to request a debrief at this stage. It is then intended to complete the contract in September. In the meantime any remaining confirmation and clarification of the contractual commitments will continue and will particularly focus on ensuring harmonisation of the legal drafting across the contract documentation including inserting details that can only be provided at contract close. To allow a limited amount of flexibility for this process to be completed the Cabinet is requested to delegate authority to the Director for Environment

& Economy to approve minor amendments to the contract and any ancillary documents which do not modify substantial aspects of the contract or the commercial agreement with Viridor as outlined in this report. The outstanding areas that remain to be finalised are set out in annex 2 (exempt).

39. Subject to the timing of gaining planning approval, the facility is expected to become operational in 2014. A separate procurement will need to be undertaken by the council in advance of this for the transfer and haulage of waste to the facility. It is anticipated that this procurement will start in 2011 and facilities will be in place by 2014 to coincide with the opening of the Ardley facility. The estimated costs of this new service were taken into account in the financial evaluation of the tender and in the value for money assessment.

Financial and Staff Implications

40. The total nominal values of the contract and the “do nothing” benchmark, i.e. landfilling over the 25 year life of the contract are greater than the current available budget identified in the medium term financial plan (MTFP). The main reason for this is that the contract and “do nothing” benchmark assume tonnage up to 2039 and the MTFP ends in March 2015. As such any tonnage growth will have to be incorporated as a pressure and subsequent savings will have to be found as part of the service and resource planning process. Any upside benefit from the share of surplus income could also be used to mitigate against any contract inflationary increase above that allowable in the budget setting process.
41. For the period covering the MTFP sufficient funding is available to support both the contract and do nothing solution. As land filling has the greatest level of uncertainty in cost if landfill tax were to increase by a further £8/tonne this would immediately bring the MTFP out of balance by around £1m.
42. Any further delay to the procurement will result in substantial cost increases which will impact adversely on the funding available within the MTFP. Financially closing the contract would ensure cost certainty, however, if planning fails would result in the council paying a substantial one-off liability in compensation for Viridor’s procurement and FX premium costs.
43. The resources required to complete the contract award process have been identified and are available within existing budgets.
44. The contract will require ongoing resources to ensure its effective implementation and management. As far as is possible this contract will be managed within the existing resources. However, a contract of this scale and complexity will require a dedicated internal resource and also depending on issues arising some external support may be required.

RECOMMENDATION

45. **The Cabinet is RECOMMENDED to award the contract for the treatment of Oxfordshire's residual municipal waste to Viridor Waste Management Ltd and authorise;**
- (a) the Director for Environment & Economy after discussion with the Cabinet Member for Growth and Infrastructure, to approve minor amendments to the form of contract, and any subsidiary or related documents, prior to its execution which do not modify substantial aspects of the contract or the commercial agreement with Viridor as outlined in the report;**
 - (b) the Director for Environment & Economy to sign any subsidiary or related documents arising from the contract; and**
 - (c) the Assistant Chief Executive & Chief Finance Officer to issue a certificate under the Local Government (Contracts) Act 1997 (the Certificate).**

HUW JONES
Director for Environment & Economy

SUE SCANE
Assistant Chief Executive & Chief Finance Officer

Background papers: Nil

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