Barnet UNISON Briefing

Failures, delays and soaring cost of Barnet Council’s Street Lighting PFI contract

September 2012

Key issues

• Delays and performance failures by the private contractor, yet the Council’s contract monitoring staff have been reduced.
• Customer surveys were not carried for 4 years, then undertaken en-bloc, now abandoned because of very poor response.
• No audit of contract for 5 years – long delays between performance failures, audit investigation and contract management remedies.
• High risks borne by Council despite supposed transfer of risk to the private sector with a Private Finance Initiative (PFI) project.
• Significant cost increases for the Council.
• Lack of regular, comprehensive and publicly available monitoring reports.

1. Street Lighting PFI contract

Barnet Council signed a 25-year PFI street lighting contract with Barnet Lighting Services Limited (Bouygues Construction and Mill Group infrastructure fund) in April 2006. Bouygues had acquired David Webster Ltd, then the UK’s third largest street lighting contractor, in June 2005 in the middle of the procurement process. It became part of ETDE, Bouygues electrical subsidiary. The £100m PFI project includes £27.7m capital works to replace 19,000 lighting columns.

2. Delays and performance failures

The contract has been plagued by poor performance and rising energy costs.

“Contract has been running for 15 months. Core Investment Programme is behind schedule. Action is being taken and targets set to bring the programme back in line by the end of October 2007” (Audit Committee, September 2007).

By December 2007, Cabinet Resources Committee – henceforth CRC, were informed that: “The 2007/08 target for replacing 5,757 columns as part of the street lighting improvement programme (PFI) has not been achieved. After an initial slow start we are catching up with the programme and a real improvement on the quarter one position has been made with 59.37% PFI columns installed, 38.63% connected and 29.39% certified as completed” (CRC, December 2007). Although performance had reached the required contractually required levels, such as the monthly number of columns installed and certified, deductions would continue until the backlog is eliminated.

Poor performance in the first year of the contract led to deductions of £112,387 (CRC, 20 June 2007). The underspend on the first three years of the contract was a staggering £901,000, primarily due to financial deductions for poor performance (see Table 1).

Two years into the contract targets were still being missed. “Due to progress made by Electricite De France (EDF) the plan to increase resources sufficiently in order to bring the programme back on target has not been achieved. Recovery meetings have taken place involving senior managers at EDF and progress has improved since Q3 and a further revised programme has been developed which attempts to bring the programme back in line with contractual milestones by October 2008” (CRC, July 2008).
The 200/10 Corporate Risk Register reported the contractor “…is progressing well with designing new schemes and installing new columns, however the progress of the Core Investment Programme has been delayed due to the lack of resources provided by the Electricity Company EDF in connecting the power supplies to the new columns. In order to recover the position a revised programme has been produced which shows the progress to be aligned with the contract milestones by April 2009. EDF have given a commitment to provide additional resources in order to achieve this target.” (Audit Committee, September 2009).

In late 2008 another problem arose because of the global financial crisis: “…there are indications that the funders may be reviewing their position in the current economic climate. Officers are meeting with contractors in order to demonstrate how they can meet their milestones and avoid contractual deductions which would provide reassurance to contractors and funders” (CRC, 1 December 2008).

Soaring energy prices were another problem. When the PFI contract commenced the Council had negotiated a two-year fixed price energy contract. However, the financial deductions imposed on the contractor for poor performance more than offset the effect on the budget due to increased energy costs. In July 2009 the Council’s two-year energy contract was 45% lower than current market energy costs (CRC, July 2009).

The Council has also followed common practice by establishing a street lighting PFI contingency fund designed to smooth imbalances between cash inflows and outflows over the contract period. PFI credit payments from the Government are frontloaded so the fund builds up a reserve to be drawn on later in the contract. It could also help to pay for future increases in energy costs.

The contingency fund was £2,677,093 on 1 April 2008 and had increased to £3,568,000 by March 2011 (CRC, June 2011).

By the end of 2008 “…the increased costs of energy under the new contract it is now necessary to vire £434,000 from the contingency into the service budget” (CRC, 1 December 2008). This was subsequently repeated. “Environment & Operations are requesting £0.436m from Contingency for 2011/12 and for future years to fund the Street Lighting PFI costs” (CRC, July 2011).

In 2009 a “…nationally recognised expert” was appointed to help manage the contract to mitigate and minimise risk issues. Their role was to “…work with service provider at the highest levels to identify short comings and address each to improve standards and hence reduce the applicable level of financial adjustments due to sub contractor default.” In May 2010 it was reported, “…historical problems reviewed and identified. Items of dispute are now resolved and this has removed the existing financial burden on service provider and hence assisted to improve the sustainability of the contract” (2009/10 Corporate Risk Register).

Contractor threatens to withdraw

Corporate Finance and Performance Risk Assessment reported that the “…contractor has struggled to deliver the required standards and as a consequence has suffered large financial adjustments. Contractor has indicated this is not sustainable and has threatened to withdraw from contract. The financial implications could be up to 50% increase annually, potentially equating to £2.25m annually” (Environment, Planning and Regeneration – Performance Overview, Q1, 2011/12).

In response, the Council were “…working on proposed amendments to contract to improve sustainability – general service provision alterations” which were 5% complete. It was also “…working on proposed amendments to contract to improve sustainability – Invest a Safe Programme Agreements” (also 5% complete) plus a report was being drafted “…providing detailed explanation analysis of the risks and options to reduce some of those risks and 50% complete” (Environment, Planning and Regeneration – Performance Overview, Q1, 2011/12).
Enfield comparison

A street lighting PFI contract was signed by the London Borough of Enfield at the same time and with the same contractor as the Barnet street lighting PFI contract. However, Enfield’s investment programme was completed on time and did not suffer the same delays:

“…the Council is just about to complete the final year of the Core Investment Programme (CIP) in 2010/11. The CIP programme has seen some 15,000 concrete columns replaced with modern street lighting infrastructure improving levels of lighting allowing for British and European levels of lighting” (London Borough of Enfield, 2011).

So why was Enfield’s investment programme completed on target when Barnet’s contract has suffered delays and poor performance?

What lessons has Barnet learnt from these two contracts?

3. Internal audit reveals further problems

The 2009/10 Internal Audit Annual Plan stated that “…a systems review of the processes for monitoring the implementation of the PFI contract to ensure an effective delivery of the service objective of reducing fear and crime through improved street lighting” was planned (Audit Committee, 10 March 2009). The following year the Internal Audit Annual Plan 2010/11 again referred to the plan to “…review the implementation of the PFI contract” (Audit Committee, 11 March 2010). The review was eventually completed in nearly five years after the start of the contract and two years after an Audit review was first proposed (Audit Committee, 16 June 2011).

The Audit Opinion of 9 May 2011 confirmed that there had been no audit ‘in this area’ for the past five years. The review concluded:

“The lack of evidence of formal proactive arrangements to routinely monitor contractor delivery against each of the contract performance standards to assess whether the contractor representations about delivery are correct and the effectiveness of the policy of allowing adjustment relief;

There were delays (in excess of target times) between when street light service requests were received by the Council (including through the Fix-My-Street route) and when they were submitted to the contractor;

The process for reporting outstanding service requests to the Street Lighting Team had ceased owing to the service requests backlog;

The failure by the contractor to undertake a significant number of customer satisfaction surveys as required under performance standard 5 in the contract;

The analysis of responses by residents to customer satisfaction surveys (where undertaken) had ceased in April 2010. Officers did not seek adjustment relief from the contractor in light of this.

The lack of a formal business continuity plan in the event of the contractor unexpectedly withdrawing from the contract” (Audit Committee, 16 June 2011).

The audit did make some positive comments, such as the monthly provision of monitoring reports of service delivery by the contractor and monthly discussion of the PFI contract and the strategic risks associated with the contractor and mitigating action. Management information showed “…the level of adjustments, the level of relief and the level of adjustment which would have been applicable without relief to assess whether the approach for providing relief results in improvement to service delivery” (Audit Committee, 16 June 2011).

“The contractor is required to meet 8 performance standards specified in the contract. Identified failures result in adjustments (reductions) to the monthly unitary charge payable to the contractor. The contractor is responsible for reporting the level of service delivery and service failures, which informs the amount to be invoiced by the
contractor. The Council is responsible for monitoring the contractor to ensure effective service delivery and to ensure that service delivery assertions reported by the contractor are correct.

Initially, the level of failures reported by the contractor resulted in adjustments, which impacted negatively on the financial viability of the contract risking contractor withdrawal from contract.

At the beginning of 2010 therefore, a management decision was taken to offer relief for adjustments in a controlled manner and where appropriate with a view to working with the contractor to optimise service delivery. The contract is approaching a critical period where the costs of withdrawal by the contractor will be significantly reduced” (Audit Committee, June 2011).

The Audit included a high priority recommendation that “…monitoring arrangements should include ensuring that the contractor undertakes all customer satisfaction surveys and assessing the extent of relief in the light of on-going non-performance by the contractor” and “…resident feedback should be analysed and issues addressed as necessary” (Audit Committee, June 2011).

4. New energy saving project delayed

Last year the Council reached agreement with the contractor to stop work on 1,520 lighting columns in the Core Investment Programme to release £2.1m towards the £4.9m cost of installing a new energy saving Central Management System designed to reduce the Council’s electricity costs. This requires fitting new electronic controls to every light (Delegated Action, Interim Director of Environment and Operations, 17 June 2012).

“Energy charges are extremely volatile and there is a risk that they may increase substantially creating a pressure on the budgets” (Quarter 1 Monitoring 2011-12, Cabinet Resources Committee, September 2011).

However, the CMS energy saving project was stalled because the bank consortium financing the PFI project expressed concern over the risks of the CMS project. “A report has been drafted providing detailed explanation analysis of risks and options to reduce some of the risks” (CRC, June 2012).

These problems were eventually ironed out with agreement between all parties, including Banks, “…to proceed with the Energy Savings programme and this will have a positive impact on sustainability of the contract. Therefore, there is still a possibility of the contractor walking away at the point at which the financial liability is reduced to the minimum point” (CRC, June 2012).

Another problem then arose when the Council was notified in April 2012 that a complaint had been made to the European Commission alleging that the Council had infringed EU procurement legislation by not tendering the installation of energy saving system (18 June 2012). The Council and the contractor, Barnet Lighting Services, had reasonably assumed that the work could be legitimately carried out within the scope of the PFI contract. The Council engaged its original PFI legal advisers, Addleshaw Goddard, to contest the complaint at an additional cost of up to £75,000 (Delegated Action, Acting Head of Legal, 18 June 2012).

This is another example of the inflexibility of long-term PFI contracts and EU procurement regulations.

5. Customer satisfaction surveys abandoned

The PFI contract requires the contractor to carry out an annual customer satisfaction survey. However, this had not been undertaken until the fifth year of the contract. In April 2011, five hundred recipients of the survey forms were agreed by the Council and contractor and duly delivered.
The Council had also requested the contractor to distribute annual survey forms for years 1-4, so a total of 2,500 surveys were distributed to residents in early 2011. By December 2011 the response rates were:

- Years 1–4: 19 returns = 0.95%
- Year 5: 2 returns = 0.40%

The Audit Committee were informed that management had decided that the contractor will no longer have to carry out customer satisfaction surveys and the requirement will be removed from the contract. An alternative method will be devised for assessing resident satisfaction (Audit Committee, 8 December 2011). There is no evidence that an alternative method of community satisfaction has been designed.

There were three reasons for the long delay in undertaking the satisfaction surveys. Firstly, the contractor claimed that the survey would only be carried out by request of the Council rather than automatically and so did nothing. Secondly, the Council's street lighting monitoring team took no action for four years despite the contractor's failure to carry out a survey. Thirdly, the council required the 2010 survey to be redrafted to take account of the revised Diversity Monitoring Protocol, which “…resulted in delays at the Service Provider’s printers on two occasions in the past year” (Audit Committee, 8 December 2011).

6. High risks remain

The street lighting contract has had a High 20 Impact Probability Rating in the Corporate Risk Register for several years. It was only recently reduced to High 15 where it remains (CRC, June 2012). PFI projects are supposed to transfer key risks to the private sector, which in turn include the cost of taking on those risks in the contract price. The Barnet street lighting PFI contract is further evidence that the transfer of risk is exaggerated and overpriced.

“…risks have been reduced but remain sufficiently high for close monitoring” but energy charges are extremely volatile and there is a risk that they may increase substantially creating a pressure on the budget. “Increased cost now until October 2012 and this is a large increase from the previous financial year as anticipated. An inflation bid is being prepared to account for the budget shortfall this creates” (Environment, Planning and Regeneration, Quarter 4, 2011/12).

7. Monitoring system and resources

The Cabinet report recommending that the Council commence the street lighting contract contained a brief section on monitoring:

> “An in-house monitoring team shall be in place to monitor the PFI contract. PFI contracts, once they move into project implementation phase are similar in many ways to other contracts procured in the traditional way. Engineers on the ground are presented with the same constraints and service delivery challenges that have to be overcome. Monitoring is therefore a pre-requisite to ensure that the performance standards contained within the project are adhered to. The information that is fed into the IT management system by the contractor needs to be accurate and verifiable. Effective monitoring therefore is necessary to ensure this happens” (Cabinet, April 2006).

The contractor is required to provide and maintain a Management Information System (MIS), a street lighting IT system to provide a full inventory of the street lighting system and record defects/responses. The contractor also operates a Customer Care System (CMS) to record all correspondence and responses. The Council’s monitoring team has access to both systems. The contractor is also required to provide a Monitoring Report detailing performance and a Payment Report at the end of each month.

“The Payment Report identifies the payments due to the contractor and this is identified by feeding the monitoring data into a Payment Mechanism. The Payment Mechanism is aligned with performance targets set out in the Output Specification. Where the service performance is
identified as not meeting the specification, adjustments are applied to the payments, which would have been due to the Service Provider. Where the performance is particularly bad a service Default Termination Point will accrue and when the adjustment level is at or above 25% of the monthly payment sum (assuming full compliance) a Default Termination Point accrues” (Audit Committee, September, 2007).

The Audit Committee were informed in September 2007 that “…the monitoring team consists of a senior Engineer, two clerks of works and a technical admin officer as well as a contract lead who is the Highways manager – Network Management” (Audit Committee, 20 September 2007). Barnet UNISON recently received information that monitoring resources on this contract had reduced to only two members of staff.

Some Quarterly Monitoring reports identified variations to street lighting costs such as £8,000 related to “…staff overspend due to agency costs” in Q1, 2011/12 and £58,000 from the “…use of agency staff covering a permanent post, redundancy costs and staff savings” in the second quarter 2011/12, which does not suggest a stable or consistent monitoring team.

Monitoring reporting
A search of Cabinet Resources Committee and Audit Committee agendas between May 2006 and August 2012 revealed only one agenda item, ‘Street Lighting Public Finance Initiative Contract Progress’ in the exempt agenda for the Cabinet Resources Committee meeting on 16 January 2007. This was the only reference we could find to a dedicated monitoring report on the £100m contract. Neither the Budget and Performance Overview & Scrutiny Committee or the Business Management Overview & Scrutiny Committee have carried out a detailed scrutiny of the street lighting PFI contract despite being provided with summaries of contract performance in regular corporate performance reports.

Furthermore, the Business Management Overview & Scrutiny Committee’s Task and Finish Group report on Contract Monitoring and Community Benefit made no reference to the street lighting PFI contract. Nor did a Value for Money Monitoring report that looked at how the Council monitors value for money and asked the Committee to consider how scrutiny could be engaged in monitoring value for money in the future (Budget and Performance Overview & Scrutiny Committee, February 2011).

The lack of a regular, comprehensive and publicly available monitoring report on a long-term contract is another example of the Council’s systemic inability to properly address the management and monitoring of contracts

8. Financial costs
The overriding financial issues have been the reductions for poor performance by the contractor and increased energy prices – see Table 1, page 7.

In the early years of the contract the final outturn cost was roughly the same as the original and revised budget figures, except for 2006/07. However, this situation had changed in 2011/12 when the final outturn was 13.5% higher than the original budget.

A review of the original business case for the street lighting project by accountants/management consultants Deloitte highlighted a £720,000 base budget shortfall. “This forecast assumes a contingency drawdown of £437,000 and a successful inflationary bid of £283,000” (CRC, 28 July 2011). (The Council commenced a two-year contract with Deloitte & Touche Public Sector Internal Audit Ltd in January 2006 at an annual cost of £65,000, which has twice been extended, CRC, March 2011).
Table 1: Changes in cost of street lighting PFI project

<table>
<thead>
<tr>
<th>Year</th>
<th>Agreed Unitary PFI payment £000</th>
<th>Original budget £000</th>
<th>Revised Budget £000</th>
<th>Final Outturn £000</th>
<th>Variation £000</th>
<th>Reason reported in Outturn Reports</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011-12</td>
<td>4,400</td>
<td>5,320</td>
<td>6,015</td>
<td>6,039</td>
<td>24</td>
<td>’small running cost overspend’ – the Q2 Performance report initially cited £58,000 cost increase from “use of agency staff covering a permanent post, redundancy costs and legal fees.”</td>
</tr>
<tr>
<td>2010-11</td>
<td>4,500</td>
<td>3,116</td>
<td>3,110</td>
<td>3,110</td>
<td>0</td>
<td>Lower reserve drawdown required resulting from programme behind schedule and performance adjustments which have negated the impact of higher energy costs this year</td>
</tr>
<tr>
<td>2009-10</td>
<td>3,900</td>
<td>3,164</td>
<td>3,094</td>
<td>2,585</td>
<td>510</td>
<td>Increase in energy costs offset by financial adjustments due to poor performance.</td>
</tr>
<tr>
<td>2008-09</td>
<td>3,400</td>
<td>2,633</td>
<td>3,059</td>
<td>2,663</td>
<td>(396)</td>
<td>The favourable variance mainly results from the “non performance” adjustments being invoked by the authority as allowed under the PFI contract.</td>
</tr>
<tr>
<td>2007-08</td>
<td>3,000</td>
<td>2,303</td>
<td>2,697</td>
<td>2,303</td>
<td>(393)</td>
<td>Despite improvements - significant contractual deductions still applicable due to initial backlog.</td>
</tr>
<tr>
<td>2006-07</td>
<td>2,200</td>
<td>2,402</td>
<td>2,754</td>
<td>2,642</td>
<td>(112)</td>
<td>Initial deductions in the early stages of the PFI contract</td>
</tr>
<tr>
<td>Total</td>
<td>21,400</td>
<td>18,938</td>
<td>20,729</td>
<td>19,342</td>
<td>(367)</td>
<td></td>
</tr>
</tbody>
</table>


Conclusions

The planned five-year replacement programme has significantly overrun since the contract is now in its seventh year.

The Council is locked into a long-term contract and has been confronted with poor performance, threats from the contractor to terminate the contract, rising financial obligations (only mitigated by financial penalties imposed for poor performance), a threatened loss of flexibility to install an energy saving management system, and had to make concessions to make the contract sustainable for the contractor! The project was at the highest level of corporate risk for several years.

The street lighting PFI contract was planned to make a significant contribution to the Council’s corporate objective ‘to reduce the fear of crime’ yet there has been no community involvement to date.

The lack of scrutiny of an important £100m contract plus the failure to provide regular and comprehensive publicly available monitoring reports is lamentable. The Cabinet Resources, Audit and Budget and Performance Overview & Scrutiny Committees receive regular summaries of contract performance, but this information is limited in scope, fragmented and often repetitive, as evidenced by the large number of references required to compile this report.

There is no effective public disclosure of the progress and key issues in this large contract. The Council’s contract management practice, scrutiny and transparency policies require radical overhaul, all the more urgent since it is planning to award two significantly larger long-term contracts in 2012/13.

Private Finance Initiative projects are claimed to provide investment, deliver good quality services, transfer risk to the private sector, provide value for money and create stable financial
obligations. To date there is little evidence that they have been achieved in the Barnet’s street lighting PFI contract. It is an appropriate time to assess the full economic and social costs and benefits of the project.

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