

# Cabinet

9 JANUARY 2012

**CABINET MEMBER  
FOR RESIDENTS  
SERVICES**

*Councillor Greg Smith*

**SERCO CONTRACT UPDATE**

Following a review of the financial and service performance of the Serco Waste and Cleansing contract, a clearer performance regime is proposed that provides greater value for money, improves service quality and is based on the principles of risk and reward.

**Wards:  
All**

**CONTRIBUTORS**

AD RSD Cleaner  
Greener and Cultural  
Services

Head of Waste &  
Parks

RSD Head of Finance  
ADLDS  
EDFCS

**Recommendations:**

**That, in order to improve service delivery cost effectiveness, the following actions be approved:**

(i) To implement a clearer performance framework within the Serco contract that rewards improved outputs and penalises poor service delivery, as outlined in paragraph 2.1 of the report and Appendix 1.

(ii) To undertake a review of current client and contractor performance management to ensure a streamlined approach that delivers MTFS savings and better service quality.

(iii) That delegated authority be given to the Cabinet Member for Residents Services, in consultation with the Executive Director of Environment, Leisure and Residents Services, to agree a mechanism and targets that ensure sustained and improved cleanliness and other contract standards over the next three years.

**HAS A EIA BEEN  
COMPLETED?  
YES**

**HAS THE REPORT  
CONTENT BEEN RISK  
ASSESSED?  
YES**

(iv) To vary the contract to allow for the potential to include the clinical waste service as outlined in paragraph 2.2 of the report.

## 1. BACKGROUND

- 1.1 Hammersmith & Fulham has a 7 year contract with Serco that commenced in June 2008 to deliver street cleansing and a commercial and domestic waste and recycling collection. There is the option to extend the contract for a further 7 years (this decision would need to be taken by June 2013). The contract is, effectively, a hybrid of input and performance based specifications, and whilst there have been periods of good performance the contract has failed to ensure that agreed standards have been achieved consistently, particularly in two areas: street cleansing and commercial waste. In addition, there is a requirement to reduce the costs of the contract to Hammersmith & Fulham in order to deliver MTFs efficiencies. This is set against the contractor's assertion that the contract has not made an overall profit to date. Indeed from January 2012, after the implementation of European Agency Workers Regulations, there is a potential further deterioration reported by Serco of up to £300K per annum. A summary of performance to date is summarised in the table below.

| <b>Indicator</b>   | <b>2009/10<br/>Full Year<br/>Performance</b> | <b>2010/11<br/>Full Year<br/>Performance</b> | <b>2011/12<br/>Q1<br/>Performance</b> | <b>2011/12<br/>Q2<br/>Performance</b> |
|--|--|--|---------------------------------------|---------------------------------------|
| The percentage of relevant land and highways that is assessed as having deposits of litter that fall below an acceptable level. (Good to be low)   | 8.7%   | 11.7%  | 2%*                                   | 5%**                                  |
| The percentage of relevant land and highways that is assessed as having deposits of detritus that fall below an acceptable level. (Good to be low) | 9.7  | 9.7%   | 2%*                                   | 5%**                                  |
| Household Recycling rate   | 27.2%  | 27.4%  | 30.71%                                | 29.10%                                |
| Resident satisfaction rating in refuse collection (%)  | 79%  | 81%  | Data expected early 2012              | Data expected early 2012              |
| Resident Satisfaction rating for doorstep recycling (%)  | 71%  | 73%  | Data expected early 2012              | Data expected early 2012              |
| Resident Satisfaction rating for Keeping public land clear of litter and refuse (%)  | 66%  | 68%  | Data expected early 2012              | Data expected early 2012              |

\* July 2011, \*\* October 2011

- 1.2 In order to improve the consistency of performance and reduce cost it is proposed to introduce a new performance framework that should, from the contractor's perspective, make the contract worth investing in and from H&F's perspective allow the client to take a less cost-intensive approach to monitoring/managing the contract with the security of knowing there are contractual remedies in place to respond to poor performance to ensure high service quality. The scope of the framework will therefore incorporate a financial assessment of profitability of the contract via a move towards open book accounting and calculate at what point incentives will arise. A model of how this could work in practice is included as Appendix 1.
- 1.3 Discussions have been held with Serco, to gauge their appetite for risk and reward. There is a view from their senior management that, as the contract already includes a number of financial risks, as outlined in paragraph 1.1, they are not willing to introduce significant rewards and penalties at this stage beyond £60K. Their

preference is to pilot such an approach for year 1 and explore an increased risk for future years, depending on year 1 performance.

## 2. OUTCOME OF CONTRACT REVIEW

2.1 The review involved H&F client, legal and procurement officers as well as Serco senior staff and has concluded that there are opportunities to vary, modify and implement existing provisions in the contract and client management structure so as to deliver:

- Reduced unit cost to Hammersmith & Fulham
- Improved and sustained performance by the contractor
- A reasonable return on investment to the contractor

This will be achieved via:

- Redefining areas of activity and responsibility
- Re-profiling Bills of Quantity rates to reflect actual costs and support a move to Open Book Accounting
- Introducing a clear and simple performance reward and penalty system via a modification to the contract (under para 15.1 of the Conditions of Contract)
- Reviewing the client side monitoring arrangements
- Potentially transferring the clinical waste service to Serco should this prove to be the most cost effective arrangement for H&F.
- Subject to there being no significant material change to the contract, rewarding improved outputs and defaulting poor service delivery

2.2 The review concluded that the clinical waste service could be added to the contract with little risk of legal challenge as the potential transfer of this service was already provided for in the original contract. However, other additional related services such as graffiti removal would need to be contracted separately with the opportunity for Serco to bid for the service along with other service suppliers, if the business case showed externalisation to be the best way of achieving best value. The clinical waste service will therefore be subject to market testing in 2012 along with other related services as appropriate.

2.3 The key performance indicators currently included within the contract are listed in the table below

| <b>KPI</b>            | <b>Comment / specification reference</b> |
|-----------------------|--|
| Resident satisfaction | Para 2.3 spec                            |
| Street cleansing      | Para 2.4 spec                            |
| Recycling levels      | Para 2.4 spec                            |
| Complaints            | Para 7.68 spec                           |

In addition, as agreed at the Cabinet meeting of 26 April 2010, an incentive scheme has been introduced for the trade waste service, although the target levels for any shared income are yet to be reached.

### 3. METHODOLOGY

- 3.1. The proposed new mechanism for rewarding enhanced street cleansing, recycling and customer satisfaction performance and defaulting poor service is detailed in Appendix 1. The weightings have been agreed with the contractor, but the targets have yet to be finalised, with Serco pointing out that any agreement needs to be subject to there being no change in Council waste policies. They have also stated a preference for year one of the mechanism to be seen as a pilot. In order to address the administration's aspiration to improve cleanliness standards over the next three years, the mechanism that is proposed rewards Serco for improved and sustained street cleansing performance.
- 3.2. The objective measurement previously used to monitor performance in this area was NI 195. Previously, by comparing scores with other London boroughs, officers have been able to benchmark Serco performance to confirm whether it sits within the top quartile, as stipulated by the contract specification. Unfortunately, due to the removal of this performance measure, such a comparison is no longer possible as only a handful of boroughs have continued to use the Keep Britain Tidy standard.
- 3.3. However, in discussion with tri-borough colleagues and following an analysis of litter scores over the past 3 years, it has been established that a cleanliness level at or above 4% would be considered high performing and within top 5 performance. This level of cleanliness has not been achieved consistently by Hammersmith and Fulham to date, and so would be a significant stretch target over a full performance year. It is on this basis that officers have commenced discussions with Serco, the final detail of which will be agreed, as outlined in recommendation (iii). The table below provides NI195 data for the past three years, with those boroughs using the KBT objective methodology highlighted in blue and H&F's performance in yellow. It should be noted that the data for 2010/11 is drawn from a smaller cohort due to the withdrawal of this measurement as a national indicator.

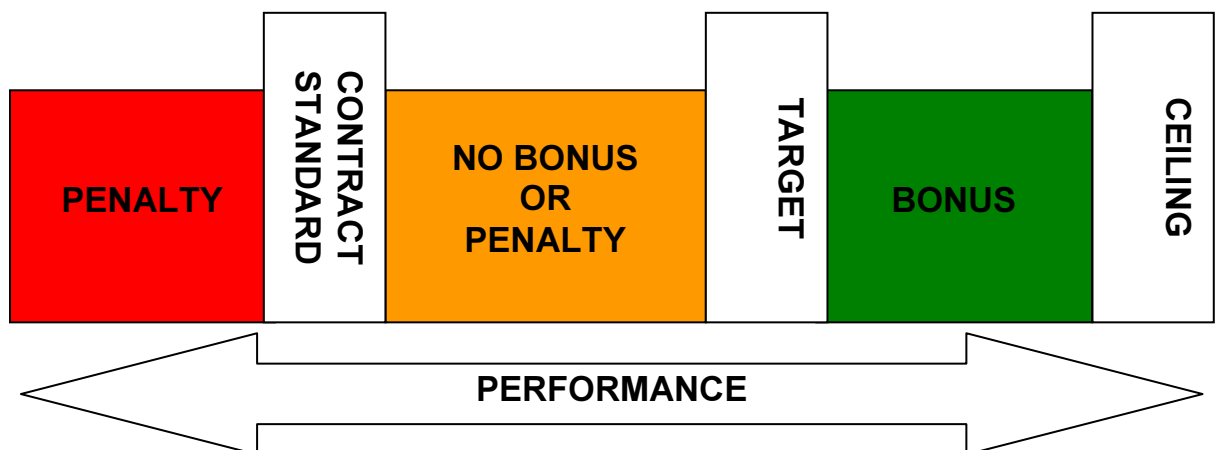
| <b>Litter</b> |  |  |  |
|---------------|--|--|--|
| <b>Top 8</b>  | <b>2010/11</b>   | <b>2009/10</b>   | <b>2008/09</b>   |
| 1             | Kensington and Chelsea Royal Borough Council (self monitoring)<br>2% | Kensington and Chelsea Royal Borough Council (self monitoring)<br>1% | <b>City of London (KBT)</b><br>2%                                    |
| 2             | <b>City of London (KBT)</b><br>2%                                    | <b>City of London (KBT)</b><br>2%                                    | Kensington and Chelsea Royal Borough Council (self monitoring)<br>2% |
| 3             | <b>Westminster City Council (WYG)</b><br>2% (TBC)                    | Barnet London Borough Council<br>3%                                  | <b>Camden London Borough Council KBT</b><br>3%                       |
| 4             | Barnet London Borough Council (self monitoring)<br>4%                | Bexley London Borough Council (self monitoring)<br>4%                | <b>Westminster City Council (WYG)</b><br>3%                          |

| <b>Litter</b> |   |  |   |
|---------------|---|--|---|
| <b>Top 8</b>  | <b>2010/11</b>  | <b>2009/10</b>   | <b>2008/09</b>  |
| 5             | Bexley London Borough Council (self monitoring)<br>4%   | <b>Camden London Borough Council (KBT)</b><br>4%         | Barking and Dagenham London Borough Council<br>4%                           |
| 6             | Haringey London Borough Council (self monitoring)<br>4% | <b>Harrow London Borough Council (WYG)</b><br>4%         | Bexley London Borough Council (self monitoring)<br>5%                       |
| 7             | <b>Harrow London Borough Council (WYG)</b><br>4%        | <b>Westminster City Council (WYG)</b><br>4%              | Richmond upon Thames London Borough Council (local benchmarking club)<br>5% |
| 8             | Enfield London Borough Council (self monitoring)<br>5%  | Southwark London Borough Council (self monitoring)<br>4% | LB Sutton (local benchmarking club)<br>5%                                   |
|               | <b>16th - LBHF (12%)</b>                                | <b>22nd - LBHF (9%)</b>                                  | <b>25th - LBHF (11%)</b>  |

3.4. The framework will operate by awarding

- a bonus for performance above the target set,
- a penalty for performance below the contract standard
- neither bonus nor penalty for performance between the contract standard and the target.

3.5. For example, if performance for target 3 resident satisfaction in keeping land clear of litter was 65% there would be no bonus or penalty paid as the contractual standards are being met, but the stretched target has not been achieved. The bonus would only be paid if performance was at 70% and a penalty paid out only if performance fell below 62.5%. Targets for each of the indicators will be reviewed on an annual basis at the annual review meeting.



#### 4. IMPACT ON CLIENT AND CONTRACT TEAMS

4.1 The proposed changes in this report have enabled a further review of client monitoring across RSD to identify any opportunities for more effective working practice at reduced cost. As part of the MTFs savings for 2011/12, one FTE

post has already been removed from this team. It is anticipated that further savings could be made with a simplified self monitoring regime and further discussions will take place with WCC and K&C to explore the optimal approach for future contract management arrangements; either merging the teams within H&F to form a generic client team, setting up a joint monitoring team with Serco or K&C, or benchmarking our performance with RBKC and WCC. Either way a further saving in this area is anticipated from 2012/13.

## 5. FINANCIAL IMPLICATIONS

- 5.1 The main purpose for implementing a financial reward and default framework is to drive up cleanliness and other key areas of waste performance across the borough. As set out in Appendix 1 and based on the proposed targets and weightings, should the contractor meet (or exceed) all of the proposed targets there will be a maximum financial cost to the Council, the amount of which is dependent on the value per point scored. Similarly, should the contractor fail to meet all of the targets there will be a maximum refund to the Council.
- 5.2 The performance framework is based on the principle that for every target achieved Serco score reward points and for every target not achieved they score penalty points. Each point is worth a financial amount. Following a request from Cabinet Members to increase the risk and reward mechanism to make the framework more attractive to Serco, discussions have been held with them on the level of risk they are comfortable with. Following these discussions, it is recommended that 1 point has the value of £1000. The performance framework could then be reviewed for suitability and applicability at each Annual Review meeting.
- 5.3 The enhanced cleansing service is the highest single priority area with 60% of the total points available being awarded for good performance in this area. It is proposed that any reward or refund for the enhanced cleansing service will be funded from earmarked reserves. Using the 1 point = £1,000 model if Serco achieved the street cleansing targets this would result in a bonus of £60,000.
- 5.4 25% of the total points available are for increased customer satisfaction. It is proposed that any reward or refund for customer satisfaction performance will be contained within existing RSD service budgets and considered as part of the ongoing MTFS process. The impact of achieving the customer satisfaction targets is outlined in the table below.

| <b>Customer Satisfaction Targets (25 points)</b> |                          |                            |
|--|--------------------------|----------------------------|
| <b>Point Value</b>                               | <b>Maximum bonus (£)</b> | <b>Maximum penalty (£)</b> |
| 1 point = £1,000                                 | 25,000                   | 25,000                     |

The targets for commercial waste can only be met or exceeded by growing commercial income. As such it is expected that this element of the performance framework will be self financing. Any savings resulting from the potential transfer of the Clinical Waste service to the contractor will form part of the MTFS process for 2012/13. Any changes to or re-profiling of the bills of quantities will be contained within the overall existing contract value.

## **6. RISK MANAGEMENT**

- 6.1. Risks are present in a number of areas and include the failure of Serco to deliver improved performance, the impact of a reduced client side, the potential for a legal challenge to the contract variations suggested and the financial risk associated with the contractor achieving maximum performance scores across all areas. The project has maintained a risk register that identifies risks and the control measures in place.

## **7. COMMENTS OF THE ASSISTANT DIRECTOR (LEGAL AND DEMOCRATIC SERVICES)**

- 7.1. It is permissible to agree variations to the Serco contract though these must be viewed on a case by case basis in accordance with a 2009 decision of the European Court of Justice (“ECJ”) in the Presstext Case.
- 7.2. Variations should not make substantial changes to the original contract (unless this was contemplated in the original tender documents and OJEU Notice). Pursuant to the ECJ’s ruling in the Presstext Case it was held that a change to an existing contract would constitute a substantial/material difference where:
- 7.3.
- the change to be introduced into the contract conditions, had it been part of the initial tender, “would have allowed for the admission of tenders other than those initially admitted or would have allowed for the acceptance of a tender other than the one initially accepted”; or
  - the change would result in the scope of the original contract being extended “considerably to encompass services not initially covered”; or
  - the change would result in a shift in “the economic balance of the contract in favour of the contractor in a manner which was not provided for in the terms of the initial contract”.
- 7.4. A substantial change to the original contract may be viewed as anti-competitive, unfair or discriminate against interested parties. Variations which are effectively the introduction of a new service, result in a different type of arrangement from that originally tendered etc may be questioned or legally challenged by interested parties and should therefore be subject to a new competitive tender.
- 7.5. Care must be taken to ensure that some of the options outlined at paragraph 2.1 and 2.2 of this Report do not constitute a substantial change to the original contract with Serco.
- 7.6. Notwithstanding the above, the Regulations 2006 set out a number of grounds for the negotiation of contracts without the necessity for open competition. These grounds though are limited and the grounds which appear to be most relevant under the circumstances are set out below. The grounds to negotiate a contract

without open competition under the Regulations 2006 are as follows (this is not an exhaustive list):

- Regulation 14(1)(a)(iii) – a contracting authority may use the negotiated procedure without prior publication of a contract notice when for technical or artistic reasons or for reasons connected with the protection of exclusive rights the public contract may be awarded only to a particular economic operator.
- Regulation 14(1)(a)(iv) – a contracting authority may use the negotiated procedure without prior publication of a contract notice when there is an extreme urgency which is unforeseeable and not attributable to the contracting authority and the time limits for a competitive tender process under the Regulations cannot be met.
- Regulation 14(1)(d)(i) – a contracting authority may use the negotiated procedure without prior publication of a contract notice when there is a requirement for additional services which through unforeseen circumstances have become necessary and cannot for technical or economic reasons be carried out separately from the original contract without inconvenience or can be carried out separately but are needed for the later stages of the performance of the contract. The caveat here is that the aggregate value of the consideration, ie contract price to be given under the contracts for the additional services must not exceed 50 per cent of the value of the consideration payable under the original contract.

7.7. To summarise, the Council may either agree a variation to the original contract which is not considered to be a substantial/material change or agree a negotiated contract with Serco provided that one of the grounds under Regulation 14(1) applies under the circumstances.

## **8. COMMENTS OF THE EXECUTIVE DIRECTOR OF FINANCE AND CORPORATE GOVERNANCE**

8.1. As set out in this report, the main purpose for implementing a financial reward and penalty framework is to drive up cleanliness and generally improve waste services across the borough, as opposed to generate additional income for the service.

8.2. As set out in Appendix 1, should maximum levels of performance be achieved, there will be a maximum financial commitment for the Residents Services Department. Similarly, there will be a maximum level of penalty/refund for under performance. It should be noted that the targets and weightings have been agreed by both the contractor and H&F and the value of each point available has been recommended at a level of £1000 per point, with the opportunity to review this at the end of Year 1. The maximum potential rewards and refunds and consequential financial risk exposure would be £100,000. Performance will be monitored, invoiced quarterly in arrears and will be reported through the Council's corporate revenue monitoring process.



8.3. It is recommended that the proposals set out in section 4 are agreed whereby any financial commitment is funded as far as possible from within existing RSD budgets (through efficiency savings on contract monitoring and waste disposal) with the exception of the enhanced cleansing service. Any reward due for the enhanced cleansing service will be funded from earmarked reserves, a maximum exposure of £60,000. LBHF reserves levels are currently above our minimum target so there is scope to fund this. Any saving in excess of the expected commitment should be included in the Council's corporate revenue monitoring process.

**9. COMMENTS OF THE ASSISTANT DIRECTOR (PROCUREMENT & IT STRATEGY)**

- 9.1. The proposals outlined in the report are designed to reduce unit costs to Hammersmith & Fulham, improve performance by the contractor and provide a reasonable return on investment to the contractor. The street cleansing element of the current contract is under performing and discussions with Serco have focused on how this can be addressed. The contract review undertaken has outlined a number of measures including introducing a clear and simple performance reward and contract deduction system via a modification to the contract. The latter should incentivise the contractor to perform more effectively provided it is well managed by the client and the correct measures/levers are chosen. Legal advice has been sought on the detail of the variations to be agreed with Serco.
- 9.2. A longer term strategy for this service is being considered, including the use of a South East consortium and opportunities around collaboration especially with Westminster City Council and the Royal Borough of Kensington & Chelsea to reduce costs and improve service delivery. However, due to contract renewal dates the earliest a contract could be jointly let would be 2021.

**LOCAL GOVERNMENT ACT 2000**  
**LIST OF BACKGROUND PAPERS**

|  | <b>Description of Background Papers</b>               | <b>Name/Ext. of Holder of File/Copy</b> | <b>Department/ Location</b> |
|--|---|---|-----------------------------|
|  | Variations to Serco Contract Project papers           | Donna Pentelow                          | RSD                         |
|  | Modelling of performance framework                    | Donna Pentelow                          | RSD                         |
|  | <b>Responsible Officer:</b> Donna Pentelow: Ext. 2358 |   |                             |

**Indicative Modelling of Framework based on 2011/12 Q1/2 data (yet to be finalised with Serco)**

**Appendix 1**

|                  | Indicator  | Frequency of Monitoring | Benchmark                               | 2010/11 Performance | Floor (Contract Standard) | Target | Ceiling | Weighting           |                   | 2011/12 Performance to date | 2011/12 Score |
|------------------|--|-------------------------|---|---------------------|---------------------------|--------|---------|---------------------|-------------------|-----------------------------|---------------|
| Street Cleansing |  |                         |   |                     |                           |        |         | Score for achieving | Score for failing |                             |               |
| 1                | The percentage of relevant land and highways that is assessed as having deposits of <b>litter</b> that fall below an acceptable level. | Three times a year      | Top Quartile results available from KBT | 11.7%               | 4.1%                      | 2.9%   | 0.0%    | 35                  | -35               | 3.5%                        | TBC           |
| 2                | The percentage of relevant land and highways that is assessed as having deposits of <b>debris</b> that fall below an acceptable level. | Three times a year      | Top Quartile results available from KBT | 9.7%                | 6.8%                      | 3.6%   | 2.0%    | 20                  | -20               | 3.5%                        | 20            |
| 3                | Resident Satisfaction rating for Keeping public land clear of litter and refuse (%)  | Annually                | Annual Residents Survey                 | 68.0%               | 62.5%                     | 70%    | 80.0%   | 5                   | -5                | 68%                         | 0             |
| <b>TOTAL</b>     |  |                         |   |                     |                           |        |         | <b>60</b>           | <b>-60</b>        |                             |               |

|  | Indicator   | Frequency of Monitoring | Benchmark               | 2010/11 Performance | Floor (Contract Standard) | Target     | Ceiling    | Weighting |            | 2011/12 Performance to date | 2011/12 Score |
|--|---|-------------------------|-------------------------|---------------------|---------------------------|------------|------------|-----------|------------|-----------------------------|---------------|
| <b>Household Waste Collection</b>      |   |                         |                         |                     |                           |            |            |           |            |                             |               |
| 4                                      | Resident satisfaction rating in refuse collection (%)                   | Annually                | Annual Residents Survey | 81.0%               | 75.0%                     | 83%        | 90.0%      | 10        | -10        | 81%                         | 0             |
| <b>TOTAL</b>                           |   |                         |                         |                     |                           |            |            | <b>10</b> | <b>-10</b> |                             |               |
| <b>Household Recycling</b>             |   |                         |                         |                     |                           |            |            |           |            |                             |               |
| 5                                      | Resident Satisfaction rating for doorstep recycling (%)                 | Annually                | Annual Residents Survey | 73.0%               | 72.0%                     | 75%        | 85.0%      | 15        | -15        | 73%                         | 0             |
| <b>TOTAL</b>                           |   |                         |                         |                     |                           |            |            | <b>15</b> | <b>-15</b> |                             |               |
| <b>Complaints and Service Failures</b> |   |                         |                         |                     |                           |            |            |           |            |                             |               |
| 6                                      | Average monthly missed repeat collections                               | Monthly                 | N/A                     | 6.6                 | N/A                       | 4          | 2          | 5         | -5         | 4.4                         | 0             |
| 6a                                     | <i>WEF Year 2: Average monthly repeat missed collections - Domestic</i> | <i>Monthly</i>          | <i>N/A</i>              | <i>tbc</i>          | <i>N/A</i>                | <i>tbc</i> | <i>tbc</i> | 5         | -5         |                             |               |
| 6b                                     | <i>WEF Year 2: Average monthly repeat missed collections - Trade</i>    | <i>Monthly</i>          | <i>N/A</i>              | <i>tbc</i>          | <i>N/A</i>                | <i>tbc</i> | <i>tbc</i> | 5         | -5         |                             |               |
| <b>TOTAL</b>                           |   |                         |                         |                     |                           |            |            | <b>5</b>  | <b>-5</b>  |                             |               |

|  | Indicator                                 | Frequency of Monitoring | Benchmark | 2010/11 Performance | Floor (Contract Standard) | Target | Ceiling | Weighting  |              |  | 2011/12 Performance to date | 2011/12 Score |
|--|---|-------------------------|-----------|---------------------|---------------------------|--------|---------|------------|--------------|--|-----------------------------|---------------|
| <b>Commercial Recycling and Waste Collection</b> |   |                         |           |                     |                           |        |         |            |              |  |                             |               |
| 7  | Net profit (000s)                         | Annually                |           | 481.0               | N/A                       | 104    | 124     | 5          | -5           |  |                             | 0             |
| 8  | Trade waste net promoter score            | tbc                     | tbc       | New                 | N/A                       | 75%    | 95%     | 5          | -5           |  |                             | 0             |
|  | <b>TOTAL</b>                              |                         |           |                     |                           |        |         | <b>10</b>  | <b>-10</b>   |  |                             |               |
|  | <b>TOTAL OVERALL PERFORMANCE (Points)</b> |                         |           |                     |                           |        |         | <b>100</b> | <b>(100)</b> |  |                             | <b>20</b>     |

**£ 20,000.00 =**  
Indicative Bonus  
based on present  
performance