



Assembly Members

10 May 2018

### **Arbed 3 Procurement**

The procurement of the new Arbed 3 area-based fuel poverty scheme has created significant public, political and media interest. With the contractual arrangements now in place, I wanted to write to you to set out the process the Welsh Government has followed, including the financial and commercial due diligence exercise undertaken and the requirements within the contract for economic development.

The letting of contracts of this sort is undertaken by officials. Ministers play no part in the process, other than to be notified of the outcome. Ministers are entitled to be satisfied that the agreed processes have been properly followed, but it is not for Ministers to seek to influence the outcome of that process. These are commercial contractual matters, in which all parties must be treated according to the rules, which govern the awarding of contracts. This letter sets out the actions taken by Welsh Government officials in putting those rules and procedures into practice in this case.

For the last two years, the Welsh Government has maintained Arbed investment through local authority grants. The previous comparable service, which made use of European funds – Arbed 2 – came to a close in 2016.

### **Warm Homes Arbed 3**

In January 2017, the Cabinet Secretary for Energy, Planning and Rural Affairs approved investment of £104m in the Welsh Government's Warm Homes programme over the coming four years to improve up to 25,000 homes. Warm Homes comprises the demand-led Nest scheme and the area-based Arbed 3 scheme.

Arbed 3 is designed to target improvements to more than 6,000 homes in areas where households are more likely to be in severe fuel poverty. In addition to improving the energy efficiency of homes, the scheme will also provide householders with a range of advice to help reduce their energy use and energy bills.

The tender for Arbed 3 set out to create a mechanism to be delivered by a single scheme manager working across Wales. The new scheme manager will be required to work with all local authorities to identify and develop high-quality, area-based schemes. These will deliver social, economic and environmental benefits by tackling severe fuel poverty, generating employment and training opportunities and reducing the carbon footprint of Wales' existing housing stock.

Welsh Government policy officials worked with the National Procurement Service (NPS) and external legal and financial experts on the tender for the new scheme manager contract, to ensure the future contract was fit for purpose, represented value for money and helped to generate economic growth in Wales.

The Arbed 3 scheme design adopted a number of recommendations from the evaluation of Arbed 2 and the lessons learned from the subsequent Arbed local authority grant schemes, including:

- The continuation of independent whole house assessments to ensure strategic aims focus on social, environmental and economic aspects;
- Robust fuel poverty data to drive interventions;
- Stimulating the local economy by requiring a minimum of 90% sub-contract opportunities to SME and micro-contractors operating in Wales;
- Clear Welsh Government branding and communication channels with householders;
- Guarantees, paid for by the scheme manager, where external wall insulation is installed;
- Quality and audit provision of the Arbed 3 scheme.

#### Warm Homes Arbed 3 procurement

The invitation to tender for the new Arbed 3 contract was issued on 26 January 2018 and closed on 28 February 2018. Two bids were received:

- Everwarm/The Energy Saving Trust (EST) – under a joint venture called Arbed am Byth
- Melin Homes in partnership with Grwp Cynefin HA, Property Tectonics, Cardiff Metropolitan University and E.ON Energy Services

Both bids were evaluated by a panel, which included policy officials and NPS against quality criteria, which accounted for 70% of the overall mark, and cost criteria, accounting for the remaining 30%.

Following a thorough evaluation, the panel determined the highest scoring bid was submitted by Everwarm/EST. NPS undertook financial and commercial due diligence, reviewed the panel's decision and confirmed due process had been followed. The Welsh Government's commercial and procurement unit oversaw the moderation of the evaluation to ensure independent scrutiny of the evaluation process and outcome.

The panel's decision was made public via a Notification of Intention to Award or a "standstill notice" on 3 April 2018. Under the Public Contracts Regulation 2015, a mandatory minimum 10-day standstill period is required – until 13 April 2018 – before the contract can be entered into with the successful bidder.

During this period Melin Homes raised a number of points of clarification via its legal advisors and requested Welsh Government extend the standstill period to allow investigation of its points.

Melin Homes asked Welsh Government to confirm:

- Whether perceived issues of financial viability and transparency of Everwarm's parent company, Lakehouse Group, had been checked;
- Had professional misconduct checks been carried out – Melin Homes referred to media reports relating to an investigation of an alleged fraud by a Lakehouse Group sub-contractor;

- Had checks been carried out on the price offered by Everwarm – Melin Homes considered it to be potentially abnormally low;
- If all scores awarded were correct and based on comparable evidence;
- There was no conflict of interest or unfair advantage to members of the winning bidder's consortium.

Melin Homes, through its legal advisors, raised further issues, in addition to those above.

Following legal advice, the Welsh Government agreed not to enter into a contract with the successful bidder until 48 hours after providing a formal response to the unsuccessful bidder's legal advisor Hugh James Solicitors. This was explained in a letter dated 17 April 2018.

Welsh Government policy officials and NPS met senior directors of Everwarm on 26 April 2018 as part of an investigation into the matters raised by Melin Homes.

The Welsh Government provided a formal response to Hugh James Solicitors on 30 April 2018 and allowed the unsuccessful bidder a further 48 hours to respond prior to the contract conclusion. No response has been received.

The assessment of Melin Homes' concerns is summarised below.

#### Issues of financial viability and transparency

Prior to the Intent to Award being published, the National Procurement Service ran financial due diligence checks on the successful bidder's consortium and Lakehouse Group, which passed the stated tender requirements.

Following receipt of Melin Homes' concerns, further due diligence was undertaken with similarly results. Financial reports were run on Everwarm Ltd and Lakehouse Group via Dun and Bradstreet and Company Watch – no concerns were identified about their financial status at the point of making the decision to award. The financial status of the relevant companies meets all requirements laid out in the tender exercise.

Melin Homes referred to a number of media articles dating back to 2011. In addition a number of Assembly Members wrote to me and the Cabinet Secretary for Energy, Planning and Rural Affairs querying the outcome of the tender exercise and repeating claims made in media articles.

Due to the seriousness of the allegations, all parties involved in the winning bidder's consortium were invited to meet officials on 26 April 2018. The Chief Operating Officer of the Lakehouse Group provided evidence and assurance about these issues. Many of these issues have been subject to legal action by Lakehouse Group and therefore it is not appropriate to comment on the details. However, no charges have been brought against Lakehouse Group or convictions obtained.

All the information in the media articles was contained within the public prospectus when Lakehouse Group was floated on the London Stock Exchange in 2015, and included full details of financial performance; risks to prospective investors was explained, including the outstanding investigation by the Metropolitan Police pertaining to the alleged fraud. In line with London Stock Exchange requirements, Lakehouse Group reports financial performance to investors annually and has a number of institutional investors with significant share holdings.

It is the view of Welsh Government officials that sufficient assurances have been provided to respond to the issues raised by Melin Homes and in correspondence from

Assembly Members in relation to the media articles, and the financial standing of both the successful bidder's consortium and Everwarm's parent company, Lakehouse Group, passes the required tests.

### Pricing issues

Welsh Government officials have undertaken a further analysis of the commercial aspects of the tenders, which showed Melin Homes were cheaper in some areas and Everwarm/EST in others. The net result is that Everwarm/EST provides a more cost-effective service, which could result in more fuel-poor households receiving Warm Homes measures.

Officials have also informally benchmarked costs against current and former Warm Homes contracts. While the costs cannot be directly related, they are broadly in line.

At a meeting with senior staff of the Everwarm/EST bid consortium on 26 April 2018, they described their own benchmarking activity against a scheme similar to Warm Homes Nest operated for Scottish Government and against a range of other public sector frameworks.

Further interest has been generated around the impact on employment in Wales. As Everwarm/EST has not secured its Welsh supply chain, it is planning events across Wales, supported by the Business Wales team, NPS and the Welsh Government's energy efficiency and fuel poverty team to publicise the opportunities for Welsh SMEs. This will include opportunities for subcontractors who worked on the previous Arbed schemes and new businesses, which will be supported to attain PAS accreditation and the creation of apprenticeships. Everwarm/EST is committed to using 100% Welsh businesses as installers and has committed to mandating the *Code of Practice: Ethical Employment in Supply Chains*, project bank accounts and paying the living wage to staff and contractors. It will also be opening new premises in Rhondda Cynon Taf.

NPS has carried out due diligence about Everwarm's performance in relation to its Scottish Government and Aberdeenshire Council contracts – both have domestic retrofit contracts with Everwarm. The council and Scottish Government have described Everwarm as being good communicators, professional and said Everwarm deliver excellent outcomes at competitive prices.

The Welsh Government has, for the last two years, maintained Arbed investment through local authority grants; the previous comparable service, which used European funds (Arbed 2) was delivered by two contractors, including Melin Homes, and came to a close in June 2016. Since this date neither of the prime and none of the sub-contractors engaged through previous schemes have raised any issues or concerns about job losses either within their own companies or the wider supply chain.

### Scoring issues

Melin Homes raised concerns about the scoring used in its original letter. Welsh Government officials subsequently undertook an independent scoring exercise and concluded the scores were fairly awarded and there was no "manifest error" in the scoring.

Subsequently, Melin raised further disagreements about the scores awarded; stating a number of areas where it alleged its scores should have been higher. Again, these were reviewed in detail but no errors were identified.

Procurement is not – and never can be – a precise science. Evaluation of tenders involves applying an element of judgment and procurement panels are created to balance individual perspectives. There is always a possibility that different panels, which

are differently constituted, may come to slightly different decisions. As with any public sector decision-making process, the fact there is disagreement does not undermine the robustness and integrity of the process or the decision itself.

In legal terms, cases involving procurement show evaluators are allowed a "margin of appreciation" and the fact there is room for disagreement about a score will not lead to a court intervening, unless there is a "manifest error" –an obvious mistake or a decision which is outside the range of marks that a reasonable evaluator could have awarded.

It is the view of NPS and Welsh Government policy officials that, having reviewed the scoring and received legal advice, that no manifest error exists.

As part of the due diligence process, an independent evaluator from Welsh Government's corporate procurement service reviewed the original area of concern raised by Melin Homes and agreed with the scores assigned by the evaluation panel.

#### Equal treatment – participation of Carbon Trust and EST in previous aspects of Arbed 2

Melin Homes also raised a concern that the Carbon Trust, a sub-contractor of Everwarm "was provided by Welsh Government with an application to assist in the development of its tender".

Following further enquiries and requests to Melin Homes' solicitors for more details about this allegation, it has not been possible to establish the exact details of this allegation.

The following details the Carbon Trust's work with the Welsh Government and the Arbed schemes to date.

The Carbon Trust has been engaged as a consultant in relation to activity under previous Arbed schemes. In 2015, Carbon Trust was engaged to assist local authorities to improve their bids for a local authority grant-based Arbed scheme, which operated in parallel to the ERDF-based scheme which Melin Homes was involved in delivering.

The local authority grant scheme required local authorities to identify potential area-based fuel poverty schemes and submit bids to Welsh Government for funding. On approval and receipt of the grant, local authorities procured a delivery partner to implement the scheme.

The Carbon Trust offered local authorities advice to identify fuel-poor areas and develop schemes in a way to lever in energy company obligation (ECO) funding. Although the criteria for securing ECO funding are publically and widely available, local authorities have varying capacity and capability, resulting in incomplete or wrongly-targeted bids for funding. The Carbon Trust provided support to create better-quality bids to Welsh Government, using well-known methods of fuel poverty identification and helped to ensure a more even distribution of quality Arbed schemes across Wales, with an increased leverage of ECO funds.

This did not relate to the tender for the Arbed 3 scheme and therefore did not give Carbon Trust a conflict of interest or an unfair advantage.

More recently, the Carbon Trust led local authority consultation workshops in January 2017, on behalf of the Welsh Government, to assist the local authority Arbed grant scheme for 2017-18. The aim was to review the process of delivering area-based housing retrofit programmes in Wales to ensure all future schemes are of high quality,

and are appropriate for the buildings and their occupants. The objectives of the session were:

- To understand the current pipeline of local authority housing retrofit projects;
- To review the criteria for the application form and bid process;
- To identify lessons learned from the delivery process;
- To identify lessons learned from the post-completion stage.

The Carbon Trust's role was to take learning from previous schemes and share it with local authorities to improve the quality of bids. This did not give Carbon Trust preferential access to any material relating to Arbed 3, nor did it relate to the tender for the Arbed 3 scheme.

#### Conclusion of investigations and Intent to Award

Following the conclusion of investigations, the Welsh Government's lawyers drafted a letter of response, which was sent to Melin Homes' solicitors on 30 April 2018. In line with the previous agreement not to enter into the contract with the successful bidder until 48 hours after providing a formal response to the unsuccessful bidder, the letter set out Welsh Government's intent to enter into the contract on a date on or after 3 May 2018. The letter also stated NPS and Welsh Government policy officials are satisfied an appropriate level of due diligence has been undertaken and Melin Homes' concerns are insufficient to further delay the contract award.

I trust this letter and the detail of the procurement process in relation to the Arbed 3 contract will provide some clarity and explanation of the rigour taken in awarding the this important contract.

Best wishes,

A handwritten signature in black ink that reads "Mark". The letters are cursive and slightly slanted to the right.

**Mark Drakeford AM/AC**  
Ysgrifennydd y Cabinet dros Gyllid  
Cabinet Secretary for Finance