CHESHIRE EAST COUNCIL

CABINET

Date of Meeting:	2 April 2013
Report of:	Head of Performance, Customer Services & Capacity
Subject/Title:	Future Delivery of ICT/HR/Finance Shared Services
Portfolio Holders:	Councillors David Brown, Peter Raynes, Barry Moran

1.0 **Report Summary**

1.1 The report outlines the options for future delivery of ICT/HR/Finance services currently delivered through a shared service with Cheshire West and Chester (CWAC).

1.2 The objectives for their future delivery are to continue to drive down costs, capitalise on existing assets and intellectual property, create value for both councils where possible and to ensure that the support services are sufficiently flexible to respond to changing future demands and to fulfil the support requirements of the Councils within a newly emerging model for service delivery.

1.3 It proposes that a Teckal compliant separate legal entity (SLE) is established as a continuation of the drive to bring cultural change, service improvement and future commercialisation to the three service areas ICT, HR, finance. This does not preclude future outsourcing or other externalisation. The opportunities presented by a full trading company in the future still remain and this decision allows a phased approach.

1.4 It sets out the drivers for change, the opportunities for future commercialisation, the risks of each potential future option and makes a recommendation, on the balance of the possible options, as to the overall best option taking into account the advantages already in place by working with CWAC, the context of increasingly outsourced delivery models for other services, learning from the current position and the readiness for total commercialisation or an outsourced model for these services.

1.5 The recommended option has been scrutinised in detail by the shared services Joint Committee over an extended time period. It has been subject to external advice from PWC, a number of key commercial experts and analysis of a full range of alternative solutions. Staff (and members) from many disciplines have been part of the analysis and there are some key background papers that have influenced the recommendation (see Section 11).

1.6 The options appraisal concludes that there are two possible viable options at this time; one based on internal trading and one a more commercial model (the SLE). If the SLE model is not supported, an alternative option is to set up the operation as a trading arm of the Councils (similar to the Direct Service Organisations of the past) with a view to moving to an SLE in the future to maximise the full benefits of commercialisation.

1.7 It is important to note that any future option now agreed is subject to financial and operational risk and to the risk of missed opportunity. No solution guarantees future cost savings, a model that will exist over the longer term or financial projections that are absolute. This is the nature of the decision in a changing market and with the current information available. However, the known financial and other risks and opportunities have been thoroughly explored and the financial assumptions have been articulated and are as accurate as possible.

2.0 Decision Requested

2.1 That Cabinet approve the setting up of a Teckal compliant Separate Legal Entity for the services currently delivered through the ICT and HR/finance shared services. The company will be owned and controlled by Cheshire East, Cheshire West and, depending on timing, a further local authority partner.

2.2 That Cabinet approve on-going work by officers and Joint Committee members which is actively seeking an additional partner to deliver the current services ICT/Finance/HR.

2.3 That the Separate Legal Entity be developed on a phased basis:

Phase 1: Change programme
Phase 2: Commercialisation

2.4 That finance is approved for the establishment of the Separate Legal Entity as detailed in Section 7 of the report. That is, one-off set up costs of £198k for Cheshire East and up to an additional on- going running cost for the half year of 2013/14 of £125k. These costs are already contained in the budget for 2013/14. This is to be a phased approach with the appointment to each position (except the lead officer) clearly agreed by the Joint Committee subject to progress against the programme plan. Once the lead officer is appointed the additional costs will be reviewed and further staffing appointments will be subject to further discussion and analysis of progress.

2.5 That the decisions relating to the detailed setting up of the Separate Legal Entity (see section 10.12) be delegated to the Section 151 officers of each authority in consultation with the Chairman and Vice Chairman of the Joint Committee and the resources portfolio holder.

3.0 Reason for Recommendation

3.1 The current shared service has been in place since the beginning of Cheshire East. Savings in excess of £6.7m have been realised across the two authorities and significant effort has been put into service improvement. The scope for further efficiencies and improvements within the existing model are now limited and whilst it is possible to continue with the current operating model, the creation of an SLE gives the opportunity to become more commercially focused and to realise other benefits for example, bringing on board additional partners to generate economies of scale and mitigating the potential reducing business from the outsourcing of other council services.

4.0 **Wards Affected**

4.1 All wards in Cheshire East and Cheshire West and Chester.

5.0 Local Ward Members

5.1 All

6.0 **Policy Implications (carbon reduction, health)**

6.1 There are no direct, additional policy implications. This recommendation is in accordance with the recently approved three-year plan including the key outcomes and ways of working for Cheshire East.

7.0 Financial Implications (authorised by the Director of Finance and Business Services)

7.1 Section 10 incorporates an analysis of the financial and other implications in making this decision. The key financial aspects to highlight are:

(i) Appendices A and B give the details of the one-off costs and the on-going revenue cost requirements for the SLE option depending on the progress towards additional partners and additional functions (“factories”) being added (e.g. revenues, benefits). This projects a positive benefit and income stream by 2015/16 based on the clear assumptions given.

(ii) The recommended decision requires a one-off input of £198k from Cheshire East which represents the costs of setting up the systems to be a separate company and the implementation costs. This amount is contained in the recently approved budget (£100k from existing capital to support Oracle) and £98k of new funding (£38k revenue and £60k capital). This is shown in Appendix A.

(iii) Phase 1 assumes that Cheshire East have an additional on-going contribution of £125k for half year 2013/14. This is included in the revenue budget assumptions for 2013/14. Appendix B shows that the on-going costs assume an additional 5 posts. These do not need to be approved immediately. If the benefits do not arise (e.g. a new partner) these costs are not necessarily required. The timing of the staffing appointments will be made with the agreement of the Joint Committee initially and then by the Directors of the company if the decision within this report is approved.

(iv) The financial benefits from gaining an additional partner are the most significant in reducing overall costs and in making the business case. An additional partner is estimated to bring in benefits of £1.4m (across the two authorities) and brings a positive financial position even without any of the other cost reducing measures e.g. additional income, additional services included. The authorities are currently actively seeking an additional partner and making very positive progress.

(v) If the Teckal compliant SLE is set up and there are no further efficiencies, no additional partner nor additional factories then the additional revenue costs (including the additional pension costs) is £291k for 2014/15 and rising as the contribution to pension costs rises. However, clearly this assumes none of the benefits of moving to an SLE are achieved but that the additional costs all remain. In reality if the benefits do not arise, alternative delivery options would be reconsidered in the medium term and, at the least, the additional costs contained. See Appendix B.

(vi) An element of the additional costs relate to the treatment of staff pensions and the effect of a smaller unit to spread the costs and risks of any additional contributions. This crystallises an inherent risk already in the current pension costs of the authority which would have to be borne by Cheshire East in the medium to longer term even if the shared service remained in place as it is now. A further element is the additional risk introduced from a pension valuation perspective. The SLE could choose a different pension arrangement for new recruits. This could mitigate the additional costs. The intention will be to make this aspect of the costs as close to cost neutral as possible. However, the figures within the Appendices assume the additional costs of pension and no mitigation for any future changes. This is included in Appendix B.

(vii) The financial implications of adopting the SLE are clearly stated above with phase 2 requiring on-going additional investment mitigated by the additional benefits of bringing in a new partner and/or additional factories and income. It will be within the authorities control to reduce the additional on-going costs at any stage if the likelihood of the additional benefits being achieved is in question or becoming unlikely.

8.0 Legal Implications

8.1 If the SLE option is the agreed way forward then legal advice will be commissioned from external legal advisors who will be recruited jointly by the two Councils to scrutinise and validate legal decisions and documentation

8.2 Legal Powers

The Localism Act 2011 introduced a general power of competence which gave local authorities power to do anything that individuals may do. The legislation was designed to remove uncertainty as to what local authorities may do and to enable them to explore innovative solutions to deliver services. The power includes the right to charge for discretionary services. However, charges must be based on actual costs incurred by the Council in providing the services and cannot include a profit element. Commercial trading must be carried out via a company. A local authority in-house service can not act as a trading company and cannot generate any profits to pass back to the Council through dividends or service charges. An internal model is restricted to full cost recovery and commercial/for profit trading can only take place if the company model is chosen. As with the exercise of any local authority powers, the Council is under a duty to act fairly and reasonably.

8.3 Local Authority Companies

Part V of the Local Government and Housing Act 1989 and the Local Authorities (Companies Order) 1995 introduced categories of local authority companies and controls which apply to each type. For the purposes of Part V, an SLE would be a “controlled” company given that the Councils will jointly own more than 50% of the voting rights and so certain proprietary controls will apply to the SLE.

8.4 State Aid

State aid involves giving financial assistance which may be seen as distorting competition and could include granting leases rent free and providing guarantees and other financial benefits which are not available to other market providers. State aid which is above the de minimus level (E200,000 over a three year rolling period) and not otherwise exempt is unlawful. The rules around state aid are complex and further specialist advice will be sought to ensure the rules are not breached. However, state aid rules do not prevent the recommended options being pursued.

8.5 Section 10.10 and 10.11 contain further information on setting up an SLE. This includes information on Teckal exemption, employment law, pensions, procurement, the shareholder agreement, property/assets and tax/VAT.

8.6 Legal implications are contained in the relevant sections throughout the report and there will be further legal input required as we progress the formation of the company, as necessary.

9.0 Risk Management

9.1 The risks can be broken down into two key aspects; (1) The risks to the authority of not achieving its objectives for these three services, in making this decision and (2) the implementation risks of the recommended option if this is approved.

(1) The current arrangements for the delivery of these three services have been reviewed and a case made for change. In assessing the options, the risk of staying with the current delivery model and alternatives has been considered. Further details are contained in Section 10. The overriding risks are that business continuity for these business critical services is not maintained followed by other key risks in terms of not maximising efficiencies, not taking opportunities to maximise future benefits, a failure to properly assess future operations and a failure to appreciate the effect of a changing design of the Council and on the overall public sector on these services. Detailed discussions and analysis have taken place over a number of months with the Joint officer board and the Joint Committee and a strategic options appraisal has been the subject of on-going debate. The culmination of this

work has led to a review of all available information to recommend a decision, on the balance of risks, opportunities and cost/benefits to move towards a Teckal compliant SLE.

(2) If the decision to move towards an SLE is taken then careful on-going risk management is key. In preparation for this the key implementation risks are being formulated and there are plans in place to mitigate the risks and ensure that they are adequately monitored and reported on once a decision is taken. Further work progressing the detailed business case will be within the remit of the Executive Monitoring Board (EMB) and will ensure that the business case is appropriately challenged at each key stage.

10.0 Background and Options

10.1 Current Delivery and Cost Comparison

Cheshire East and Cheshire West Councils have been sharing ICT, HR and finance services since their inception in April 2009. The shared service has built up a significant amount of intellectual capacity in shaping and delivering the shared service. Financial savings exceeding £6.7m have been achieved.

The services currently cost just over £14m per annum to deliver. In order to review value for money, both ICT and HR/finance undertake regular benchmarking activity to compare costs and delivery, prompt service improvements and as a challenge to current delivery. Benchmarking nearly always raises questions and is a time consuming exercise to ensure that correct comparators are used. The last exercises were undertaken in 2011 and two reports are available – ICT, Gartner (external) report on ICT costs and a PWC comparison of staffing costs in HR and finance. Further benchmarking is due to take place in 2013/14 and the costs of the external support for this assumed in the budget. The overarching findings are that ICT costs were below average and that HR/finance were in the upper quartile (i.e. cheapest) of those included in the survey. This is a simplification of the extensive information and analysis but is included for context to show that the services are not inherently non competitive or inefficient. However, clearly they will become so if change is not now embraced.

10.2 Core Purpose of the Review and Drivers for Change

It is clear that the Councils require value for money from our current ICT, HR and finance support services ensuring that we continue to drive down costs, improve quality and take account of changes in technology and the market. This needs to be considered within a context of emerging new delivery methods for front-line services which will impact upon the nature and level of business for support services. Clearly the national picture of a reducing level of central funding to local government, increasing demand and an increasing need to operate with commercial acumen are all influencing factors.

The objectives of this review are to drive down costs; capitalise on existing assets and intellectual property; create value for both councils where possible; and to ensure that the support services are sufficiently flexible to respond to changing future demands and to fulfil the support requirements of the Councils within a newly emerging model for service delivery.

10.3 Consideration of the Options

In order to achieve the core purpose and to ensure relevant options have been appropriately considered PWC were commissioned in 2010 to assist. The key outputs were four separate documents; Strategic options for shared services; collaboration and trading – high level business strategy; market analysis for shared services; and due diligence outputs. In August 2012, the Joint Officer Board and Joint Committee revisited the findings in 2010 and 2011 and a further strategic options appraisal and high level business case was produced. This was also informed by two further external advisors both with extensive knowledge of the sector. The result was a 65 page report examining the 6 main options and what each would entail. This is available on request and gives more detailed information on the options and consideration of each.

The following sections summarise each of the options. A useful chronology to consider the options is to first examine the option to disaggregate what is currently in place. When and if, this option is rejected then there are two possible paths to improvement; internal options and external options. The decision is a balance of judgement as to the risk and opportunities of each option given all factors.

10.4 Disaggregation

The strategic options appraisal accepted by the Joint Committee (October 2012) concluded that this option should be rejected. It is costly both in terms of one-off costs of disaggregating, losing economies of scale, losing the advantages of already sharing the services and would be time consuming for no tangible advantage. In addition, it prevents building on the opportunities presented by having a well developed service to bring in new partners and goes against the general policy drive for sharing services in the public sector. The advantage of this option is that it gives each authority autonomy to make its own decisions in the future and to consider all alternative delivery options from a single perspective. It is, however, the most costly and potentially disruptive of all the possible solutions. The most significant risk of this option is that it destabilises the current service for little immediate advantage except that of autonomy. It is, therefore, not a recommended solution.

10.5 Improved Internal Provision

This is clearly an option. The advantages are that it does not disrupt the current position, there are opportunities to improve the service through bringing in additional resources and expert staff (as in the company model) which could enable similar advantages to the company model whilst maintaining the current governance arrangements. Within the improved internal provision options there are the following alternatives. Each is considered in terms of its advantages, risks and opportunities:

(a) Do nothing “as is”

The overarching consideration is that there are now limited opportunities to deliver more for less within the current model. The advantages are that it does not require significant investment, it maintains a degree of stability, all energy could be put into making service improvements rather than on changing the model and it allows time to consider the effects of changes to service delivery across both councils and the changing public sector. The disadvantages are that it does not address the gradually reducing level of core business, it will not promote a commercial, client-focused culture (as it hasn’t to date), the governance arrangements are sometimes challenging as a result of one partner being the host, it is costly and perceived as bureaucratic and the client/deliverer split is not clear. It would also not address the issue of staff being on differing terms and conditions and lack of a unique identity for the three services as a whole.

The risks of this option are low in terms of immediate effects on the delivery of these business critical services. However, the risk of a missed opportunity to improve the model, make it sustainable in the longer term and to drive forward a commercial operation are significant. This includes the lost opportunity to drive further efficiencies, capitalise on the existing assets and intellectual property and the potential to create future value in a company with potential to bring in new partners and in longer term be profitable and have saleable value. This option is not recommended.

(b) Transfer Model

This option involves one or other of the Councils becoming the lead authority and employing all the staff working in each shared service, thus harmonising terms and conditions. To be equitable, splitting the functions between ICT and HR/finance would be the likely solution. The advantages are that it would eradicate some perceptions that the current host (the West) has undue influence and would be a step towards harmonising staff terms and conditions by all staff being employed by one or other authority for ICT, HR or Finance. The disadvantages of this option are that it is a quasi- disaggregation in that rather than bringing the ICT/HR/finance services closer together into one business unit, it would bring additional separation. The risks to this option are that it does not achieve the majority of the objectives; it would not bring an additional focus on driving down costs; does not capitalise on existing assets and, does not anticipate reducing volume/increasing unit costs nor changing future demand. This option is not recommended.

(c) In house Trading

This is the most viable of the internal options. It involves setting up a joint in-house trading operation similar to the former Direct Service

Organisations (DSOs). The main advantages are that it would allow a move towards a more commercial, customer-focused culture, provide more transparency on unit costs, the set up costs would be low and there would be clear ownership by the two authorities. It would also allow the development of its own brand and is a known venture i.e. we have done this before. The level of investment would be similar, but lower than that of a company model. The on-going savings possible are shown in Appendix C (compared to the company, SLE model). The main aspect of a positive financial projection is an additional partner. Therefore, the comparison between this option and the company model rests on the likelihood of another partner being brought into the model and this is judged to be lower than in the company model. It can be argued that this model couldn't work well for three authorities/partners even though it is viable for two. The additional costs are lower than the company (SLE) model (because of pensions and not having to operate as a separate company). If the benefit of a new partner is attributed to this option, this appears the most financially positive option. The disadvantages, however, are that it does not offer the same benefits to trade commercially, is less likely to be attractive to additional partners and it does not meet all of the objectives in that it does not capitalise on the existing asset and intellectual property nor create a value company for each authority. In addition, it does limit future expansion in that it is unlikely to be sustainable for a growing number of partners. The main risks to this option are that further efficiencies are less likely as full commercialisation is not possible, the lower likelihood and increased difficulty of operation in attracting an additional partner and the lost opportunity to trade at profit.

Appendix C shows that by 2014/15 this option is a financial saving against the current shared service, even without an additional partner and potentially more financial advantageous than the SLE option. However, it is limited in scope in the longer term.

10.6 Externalisation

The following external delivery models are all potentially viable alternatives. Each is considered in terms of its advantages, risk and opportunities.

(a) Outsource

This involves the selection of an external private sector supplier being paid to provide the services on behalf of the Council. The advantages of this option are that there is likely to be an immediate return on investment and lowering of costs, it gives access to private sector capability, it moves the operation out of the authority potentially freeing up additional capacity and reducing "noise," the majority of the services are standard and, therefore, suitable for specifying and monitoring in a tangible way, it brings access to wider experience/best practice and the outsourced provider is likely to become a change agent and give impetus to improvements. The disadvantages of this option are that it relies on highly detailed specification and process to ensure that efficiencies are retained by the Council rather than handing the provider a lucrative means of profit at the expense of the Council. There are a number of highlighted risks involved in outsourcing e.g. potential dissatisfaction about loss of control and high exit costs making this option virtually irretrievable. This makes this option high risk at the current time as there are so many uncertainties around level of business and emerging ICT choices whereas this option would tie the authority into a medium term agreement. The main risk would be that this option would not maximise the efficiencies to the Council and that it would restrict flexibility around emerging delivery options across the Councils. This option is not recommended at the moment but that does not preclude either full outsourcing of the business in the medium term or aspects of the business being commercially procured in the future (e.g. CLOUD).

(b) Joint Venture

This is a legal entity set up between the parties to jointly deliver the services. The private sector is typically the majority shareholder. To make this a viable commercial proposition the tie-in tends to be 8- 10 years. This is usually used where the objectives relate to diversification, growth and business improvement. There are high profile examples of successful joint ventures in the public sector (e.g. Liverpool Direct). Equally there are some high profile failures relating to this option. The advantages are that it provides access to commercial skills and private sector delivery capability, transfers risk to the partner, is more likely to attract additional business and allows expansion and diversification. The disadvantages are similar to that of the outsourcing option and the lack of specific information on the likely cost reductions compared to the level of risk by being constrained in the longer term whilst service delivery models for front-line services are being transformed. The option itself is viable and has proved successful in other areas of the country. It is an effective way of bringing in commercial expertise. However, the timing and risk of being unable to achieve savings and not having the capability to specify the outcomes and guaranteed business levels makes this a high risk option at the moment. It is not recommended.

(c) Separate Legal Entity (SLE).

This model is appropriate where there is a desire to trade commercially for a profit with other public and private organisations. It involves establishing a separate legal entity which will deliver services back to contracting authorities. There are a number of forms this can take such as a company limited by shares or guarantee; a community interest company; and industrial and provident society. The initial legal advice suggests that the most suitable structure for Cheshire shared services is a company limited by shares which is Teckal compliant (this is explained more in the following section).

This model satisfies all of the objectives outlined in 10.2. It would create a commercial and customer focused culture akin to the private sector whilst retaining all efficiency gains within the participating councils. It would enable the sharing of overheads across a broader base and potentially capitalise on the assets and intellectual property already built up. It is a strong base to bring in an additional partner which gives a clear efficiency gain and economy of scale to assist future sustainability. In the longer term, if the company became a full trading company (ie not Teckal compliant) the additional benefits are the ability to trade more significantly and develop commercial relationships with local businesses, opportunity to invest savings in the local economy and operational independence to generate profit and sell shares.

This option requires investment in two ways: one-off set up costs and on-going costs of being a company (including initial additional staffing and increased pension costs). This is clearly shown in Appendix A and B.

The balance of judgement required is as to whether the additional one-off costs and the short term, additional on-going running costs should be invested to gain the additional benefits arising from the more focused commercial culture, much higher likelihood of attracting an additional partner, increasing trading income and driving down costs. With an additional partner, by 2015/16 the model provides a positive net financial impact of over £1m across the two authorities. The assumptions around these costs have been thoroughly reviewed and whilst it clearly depends on the partner and a number of other prevailing circumstances the additional partner is the key to the efficiency which is substantial. Equally, in theory these benefits also arise with an internal trading model.

To mitigate some of the risk and to control the phasing of the additional on-going costs the five additional appointments (see Appendix B) could be contained to one initially (the MD role) and the appointment of each of the other posts conditional on a new partner being on board and/or at the discretion of the SLE following the company being set up and MD appointment. This is covered in section 7 (iii) and that is the recommended position.

Given the above, the key risks are that the additional investment is made but that the benefit of an additional partner does not transpire and that the service may temporarily decline as energy is invested in the setting up of the company rather than the quality of service delivery. Whilst these risks are substantial, they can be managed and the decision is as to whether the potential benefits justify the additional initial cost and risk. It is also a matter of judgement whether the benefits are most likely to be achieved by an in-house trading model or an SLE. On balance the Joint Committee has recommended that this option is recommended for approval.

10.10 Further Examination of Risks, Financial Assumptions and Implications

(i) Corporate Support Services. The financial information assumes that existing costs of providing support to the current shared service are transferred to the SLE (£1.47m per year covering HR, Legal, Finance, Accommodation costs). This represents approximately two thirds of the total current estimated support cost and there is detailed work to be undertaken to achieve this. The costs have been estimated to assist the comparison between the existing cost and the new cost and is the most accurate assumption that can be made at present. A high proportion of these costs are accommodation, the SLE could be given the freedom to challenge/reduce all support service costs once the company is set up.

(ii) The additional benefit of a new partner assumes that the partner will fund all initial set up costs for a higher proportion of the on-going financial gain (66%). This will be subject to negotiation with any partner. The business case is financially positive with an additional partner regardless of the specific assumptions as the economy of scale benefits to all partners is significant.

(iii) Tax and VAT. The SLE will have to pay income/corporation tax on any profits and the special VAT provisions that apply to the Council will not be available to it. Corporation tax should only become payable if the SLE is successfully generating new sources of income and therefore this does not fundamentally affect business case. For VAT purposes, most of the services will be taxable supplies and therefore there should be no VAT implications of the change in model. HMRC have recently introduced new regulations known as “cost sharing.” If these regulations were to apply to the SLE they would affect the business case and financial benefits. External professional advice has been taken and the expectation is that these regulations will not have an adverse impact. This is, however, a remaining risk but is considered low in terms of the VAT risk.

(iv) Pensions

Local authority staff are entitled to pension protection under the best value authorities staff transfer pensions Direction 2007. The protection is that a new employer must provide all transferring staff who are members of the Local Government Pension scheme (LGPS) with continued access to the LGPS or to a broadly comparable scheme. The SLE will be able to join the LGPS. It is proposed that the Council act as a guarantor during the phases of the SLE’s development. The alternative to this is that the SLE would be required to provide a pension bond. This is estimated to be in the region of £4m.

This is a complex area. The main financial risks have been reflected in the increased pension costs in the financial case at Appendix B. Each employer in the pension fund pays a standalone contribution rate reflecting the demographic profile of their members. The actuary will make assumptions about the expected returns from the fund's assets. These assumptions are derived objectively from the financial markets at the date of staff transfer. The financial markets and hence the actuary's assumptions for investment returns are currently significantly lower than those assumed as part of the 2010 valuation. As a consequence, recent experience is that employer contribution rates for transferred staff are higher over the short to medium term than the rate paid by the Councils. The Council's own contribution rates will face upward pressure when they are reviewed in 2013. However, the key difference is that the local authorities have more flexibility in terms of phasing in the increases in contribution rates over a longer period of time and therefore reducing the impact in the short to medium term.

The assumption in the financial business case is to phase any increases in equal instalments over the development phases. However, as the Council's are still paying contributions set at 2010 valuation, the phasing of any increases to the SLE's rates puts the Councils in no worse position than if staff had remained in-house.

It is proposed that the Council will retain the pension deficit accrued up to the date of transfer. This is consistent with the approach that would be taken with a more traditional outsourcing. The budget of the proposed SLE will be reduced to reflect the annual cost of the liability taken on by the Council. The financial assumptions do not include any benefits from either closing the LGPS to new members post transfer or the Hutton review. Both options have the potential to produce significant savings over the long term and mitigate the additional contributions shown in the financial analysis. The closing of the pension scheme to new members is clearly only an option where Local Government ceases to be the employer (for example the SLE option or outsourcing) and not the internal trading option

(v) Phased Approach

The Joint Committee have established that the development (if approved) should be a phased approach:

Phase 1: Change programme. Create the company, the company board, shareholder committee and appoint management team. The business focus in this initial phase is concerned with improving the quality of service provision within the new structure and with a new culture, whilst continuing to develop the future commercial company propositions. Bring in new partner.

Phase 2: Commercialisation Programme. Company develops robust plan detailing how it will grow the business, proposition branding developed, marketable service packages and selling points established.

10.11 Further Explanation and Information on Teckal and the SLE

A Teckal compliant SLE means that the Councils can contract with it without a procurement exercise. The Teckal exemption was established by an EU case and must satisfy two conditions; the ***control test*** (the contracting authority must exercise control which is similar to that which it exercises over its own departments and, the ***activities test*** (the SLE must carry out the essential part of its activities for the Councils and other activities must be of only marginal significance). Further information is available as to how the control and activity tests apply. In order to satisfy the control test and to reassure members the Council can put limits on the decisions which can be taken by the company e.g. decision to enter into a partnership arrangement, pension liabilities, significant pay rises.

Shareholder agreement

The way in which the two Councils and the SLE deal with each other will be set out in a shareholder agreement. The matters covered by the agreements could include:

- The issue of new shares, for example, to a new partner
- Exit arrangements including provision for what happens if one shareholder wants to sell their holding
- Management of the SLE – for example, rights to appoint directors (usually covered in the articles as well)
- Appointment of external auditors and rights of access for the Council's auditors
- Financial reporting arrangements
- Future funding
- Confidentiality
- Deadlock provisions

If the decision to create an SLE is approved this is a key area of discussion for the two councils and is an opportunity to ensure the appropriate level of control and intervention whilst not being so restrictive as to mitigate the benefits of a more flexible delivery model. This should provide comfort to members that the Councils will be able to influence decisions and future solutions.

Employment Perspective

Approximately 330 (FTE) staff will be affected by a transfer into an SLE. This would take place under the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE). Given the scale of transfer there may also be support staff who could be within the scope of TUPE and further work would be required on this issue. A full consultation exercise will be carried out with staff.

Property and Assets

The management of assets including ownership of the network will require careful consideration taking into account any state aid issues and the Council's exit strategy. Further work is required to develop an agreed approach. The Head of terms for the licenses/leases for premises will be based on legal advice.

10.12 Further Decisions

If the decision is taken to create the SLE, there are a number of necessary additional decisions and actions required. The Section 151 officers (in consultation with the Heads of finance and head of legal services) and with the Chair and Vice Chair of the shared services Joint committee should be authorised to:

- Finalise aspects of the business case which need further clarification e.g. saving from the specific additional partner, level of lead officer post. This will need to go through the EMB.
- Recruit and appoint an interim lead officer for the SLE.
- Finalise the form and structure of the company following detailed legal and financial advice.
- Develop the operation of the commissioning functions within existing resources
- Agree the memorandum and articles of association based on the principles outlined in the report including those matters reserved to the Councils as shareholders
- Agree funding arrangements
- Agree the scope of services to be commissioned from the SLE, the performance management framework, the contract length, price and payment mechanism.
- Agree the terms of the shareholder agreement
- Oversee the completion of the due diligence work
- Agree the terms of the licenses/leases required and such detailed terms or conditions as deemed appropriate by the Heads of Legal services.
- Agree the principle of buyback of corporate services
- Agree in principle to guarantee pension liabilities for the wholly owned company for the duration of the contract in respect of Council staff transferring to the company. The scale of the guarantee is likely to be in the region of £4m.
- Agree in principle to provide such financial guarantees as the company may reasonably require for the duration of the contract subject to the approval of the Head of Finance (subject to standing orders) on a case by case basis including parent company guarantees and bank guarantees.

11.0 Background Papers

The Future of Cheshire Shared Services - Strategic Options appraisal and High Level Business Case (13th December 2012)
Strategic Options Appraisal for Shared Service
Collaboration and Trading – High Level Business Strategy
Market Analysis for Shared Services
Due Dilligence Outputs
Various presentations and papers for CE/CWAC Joint Committee for Shared Services

The background papers relating to this report can be inspected by contacting the report writer:

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