4 Commercial Aspects

4.1 Introduction

4.1.1 Adopting a commercial approach to the project is fundamental to determining that the Council gets the best deal from the market. As part of the Strategic Business Case, soft market testing has already been undertaken and has determined that the market exists to provide this type of service delivery.

4.1.2 In addition, good practice suggests that site visits of other comparable local authorities, with similar partnership arrangements should be carried out to see partnerships in practice and identify issues and further approach. At the time of writing this report a number of site visits have been embarked on.

4.1.3 Furthermore, the competitive dialogue procurement process will provide an opportunity to endorse the projects commercial approach.

4.1.4 This chapter defines the current progress of the commercial aspects requirements. Areas this chapter considers include:

- Output Based Specification
- Sourcing options
- Payment Mechanisms
- Risk Allocation and transfer
- Personnel issues – TUPE vs. Secondment

4.2 Output Based Specification

Strategic Business Case - Output Based Specification comments

4.2.1 As part of the soft market testing undertaken as part of the Strategic Business Case the potential suppliers were positive about the potential to use output based specifications. It was however recognised that this may not be possible across the full spectrum of activities likely to be included in the partnership, with some elements currently more suitable than others and a dependence on the quality of inventory in service areas.

4.2.2 For example the reactive maintenance service has a clear set of service criteria with inspection frequencies, intervention levels and repair timescales. The City can also provide historical data as to the volume and types of repair that this regime has generated. As a result, in theory, potential partners could be asked to quote a price for the annual provision of the service, rather than for individual repairs or inspections. In this scenario the payment of any fees would be dependent on meeting required standards of service.

4.2.3 In other areas, such as planned maintenance, it may be difficult to move immediately to a purely output based specification, and it may be necessary to use a mixture of scheduled rates, target costs and output specifications initially, although there was agreement that output specification is the aspiration.

Current Position

4.2.4 The Output Based Specification does not need to be developed in great detail and depth at this stage for the following reasons:

- The need to secure the approval for the preferred model prior to undertaking this significant piece of work
- The competitive dialogue stage of procurement will be used to shape and inform the Output specifications with the market

4.2.5 This section provides industry guidance and Appendix G illustrates an example of a framework for the contents of an Output Based Specification for a business service based procurement. It is not intended that this framework should be prescriptive; the Output Based Specification for any procurement should reflect the requirements of the organisation and the circumstances of the procurement. The headings and contents lists will need to be tailored for each procurement situation.

What is an Output Specification?

- An Output Based Specification (OBS) focuses on the desired outputs of a service in business terms, rather than a detailed technical specification of how the service is to be provided; this allows providers scope to propose innovative solutions that might not have occurred to the procurement team.
- The Output Specification is arguably the most important document in the procurement of a project. It is the basis through which the local authority defines the services and outputs or outcomes that it requires from the service provider for the term of the Contract. Since a well-developed draft of the Output Specification is required for the business planning process and development of OBC, consideration must be given to the development of the Output Specification at an early stage.
- The Output Specification should aim to detail what needs to be achieved not how it is to be achieved. What is not wanted should also be specified to ensure that all areas have been covered. Such generally framed outputs however cannot in themselves guarantee that the appropriate services will be delivered. Specificity comes from defining appropriate performance targets for each of the outputs or outcomes required.

Why an Output Specification?

4.2.6 A well-drafted Output Specification is fundamental to developing a robust partnership contract and the successful delivery of long-term services. It is part of a process that is radically different to traditional procurement, in that the emphasis is on affordable service outcomes and outputs, the explicit allocation of risks, and the integration of design and build with the operation of the services.

4.2.7 Developing a specification in terms of outputs is likely to encourage a focus on strategic needs and future service requirements, rather than the history and detail of current provision. A well-produced Output Specification should allow the introduction and development of new ideas about the design, installation and operation of the service. Most critically, because the approach encourages bidders to develop the means to deliver the outputs within the context of a fixed, performance-related pricing mechanism, it focuses much more attention on project risks. This should lead to a better-designed and operated service over the whole life of the proposed project.

What constitutes a good Output Specification?

4.2.8 Producing an effective Output Specification involves the art of defining the end without specifying the means. Outputs should clearly and comprehensively state what is

required, and the standards to be achieved. In summary, a good Output Specification must:

- Reflect the local authority's corporate and service policy objectives
- Be clear, concise and unambiguous
- Give the potential bidders sufficient information to decide and cost the solutions they will offer
- Take account of the need for compliance with legal or other statutory requirements and policies, and any compatibility requirements
- Specify any constraints that are essential to defining a deliverable solution; for example corporate practices. These should distinguish between mandatory and other constraints
- Permit solutions to be evaluated in the procurement process against defined criteria
- Identify those functions or aspects of the service that are critical to the performance of the service and which, therefore, will be given most weight in the Payment Mechanism
- Only contain requirements that can be afforded by the local authority and are deliverable.

4.2.9 In essence, a good Output Specification must communicate what is expected from bidders, leaving them room to produce innovative, cost-effective solutions to the clearly specified needs and requirements of the local authority. Statutory requirements may differ according to whether they apply to existing or new services. Care should be taken to ensure that bidders are clear on these issues, and that over, or under-specification, does not unwittingly occur.

Bidders' responses to the Output Specification

4.2.10 Local authorities will need to determine, as part of developing the Output Specification, what information will be required from bidders as part of the bid submission. It is likely that such information will fall into two categories:

- Information that will be used as part of bid evaluation only
- Information that will be used for bid evaluation and will also become contractual (i.e. will be inserted as schedules to the Contract).

4.2.11 4ps suggests that this is done through: Requesting contractual Method Statements (sometimes collectively encompassed in a Service Delivery Plan) that will become a schedule to the contract. For example, bidders' responses on monitoring should become a contractual Method Statement, since these will form a link between the Output Specification and Payment Mechanism

Who produces the Output Specification?

4.2.12 In developing the Output Specification, local authorities should be able to draw on their experience of standard setting in other tendering exercises. Technical advisors will need to be appointed to assist if appropriate in-house expertise or resources are not available.

4.2.13 The production of the Output Specification must not be left solely to advisors, but should involve all members of the project team and other relevant stakeholders. Involvement and discussion of the outputs required is likely to result in wider ownership of the end product, and thus contribute to a better partnership.

How to prepare the Output Specification

4.2.14 Local authorities are adopting a number of approaches to developing the Output Specification. These are:

- It is suggested that the most effective approach is as a starting point, to use a model Output Specification, and to use facilitated workshops to refine and develop the Output Specification to ensure that it meets local circumstances and service delivery arrangements, and the local authority's own particular needs.
- Another approach, but one that is compatible with the use of workshops, is to start off with the existing service (input) specification and convert it into output requirements. At the outset it may be easier for many of the stakeholders to think in terms of inputs and this may therefore be a suitable way of kick-starting the Output Specification process. Care must be taken, however, to ensure that the end product does not retain unnecessary or unsuitable inputs.

4.2.15 Stakeholders need plenty of time to develop their understanding of the partnership and to work on their contributions to key documents such as the Output Specification. Local authorities should not underestimate the amount of time that is required for these purposes

Determining and defining outputs

4.2.16 The following questions provide a useful framework for determining and defining outputs:

- What are the objectives of the services to be provided?
- How can these objectives contribute to the successful delivery of the service?
- In the light of these objectives, what is definitely not wanted?
- What is open to competitive dialogue?
- What is the standard and level of service that must be delivered?
- What is desirable over that level and standard, if affordable?
- What service parameters are immutable/discretionary?
- How do services and outputs rank in terms of functional criticality?
- What is likely to change over the life of the Contract and what are the potential drivers? How can such changes be allowed for in the Output Specification?
- Is it possible to translate the specified standards into performance measures within the Payment Mechanism?

Phasing and timing of developing the Output Specification

4.2.17 A well-developed draft of the Output Specification should be produced at the OBC stage to provide a guide to developing the key principles, objectives and requirements of the project, and to inform the financial modelling of the project and procurement options. The draft Output Specification should reflect the outcome of any market-sounding exercise.

4.2.18 A succinct summary or outline of the Output Specification should be incorporated in the Descriptive Document, for issue as part of the pre-qualification stage of the procurement process. The Output Specification should then be fine-tuned following the initial competitive dialogue (short-listing) stage, taking into account any further ideas generated during the short-listing process.

4.2.19 It is acceptable to fine-tune the Output Specification further, taking account of views received from bidders. The overall form and approach, however, must not change significantly because of the need to comply with the Procurement Regulations in terms of fair and transparent competition.

4.3 Sourcing Options

4.3.1 The rationale for selecting the preferred option of a public/private service model is well documented in the options appraisal sections of the Strategic Business Case and is discussed briefly in Section 3.3 of this business case.

4.4 Payment Mechanisms
Current Position

4.4.1 The Payment Mechanisms do not need to be developed in great detail and depth at this stage for the following reasons:

- The need to secure the approval for the preferred model prior to undertaking this significant piece of work
- The competitive dialogue stage of procurement will be used to shape and inform the payment mechanisms with the market

4.4.2 The information below provides guidance on what is involved in payment mechanisms and a process on how to develop them, plus other information for the benefit of the Council.

Objectives of the Payment Mechanism

4.4.3 The Payment Mechanism is fundamental to the contract, as it puts into financial effect the allocation of risk and responsibility between the local authority and the service provider. The payment mechanism should be objective, transparent, and easy to operate. It ensures that the local authority's objectives for the project are being delivered, and it should be linked to the outcomes and outputs for the project set out in the Output Specification.

4.4.4 The Payment Mechanism should include appropriate incentives for the service provider to deliver the service in a manner that gives Best Value, and promotes partnership working.

4.4.5 The Payment Mechanism for a project will need to be tailored and structured to reflect the particular needs of the local authority and the relevant stakeholders, and the nature of the deal. For those involved in developing the Payment Mechanism, it is vitally important to see the 'fit' between:

- the service requirements set out in the Output Specification
- the Payment Mechanism
- the Contract monitoring regime
- the different roles that the local authority and individual stakeholders will play in them

4.4.6 Other objectives of the Payment Mechanism should be to:

- Provide the means by which the service provider can secure the full unitary charge (i.e. the agreed payment for the service agreed in the Contract) for delivering the service within a framework of realistic, challenging, but achievable performance standards
- Provide an incentive to the service provider to meet the performance standards set out in the Output Specification by placing payment of the unitary charge at risk if performance falls below the agreed standard
- Match payments to the outcomes and outputs that the local authority wishes to see delivered from the service project

- Provide an incentive for the service provider to rectify problems by escalating penalties for worsening performance, or failure to act promptly on items failing to meet the agreed performance standards and performance targets
- Provide an incentive for the service provider to innovate and secure efficiency gains and deliver Best Value throughout the period of the Contract.

4.4.7 A specific objective of the Payment Mechanism for a project may be to seek support from the service provider to enable the local authority to demonstrate that the project is meeting, and continues to meet, the service objectives developed for the scheme as part of the initial appraisal.

4.4.8 The Payment Mechanism will determine whether and how much the service provider is paid at the end of every payment period designated in the Contract. In determining the appropriate parameters to be included in the Payment Mechanism, regard will need to be given to the measurement and prediction of those parameters, and the ability of the service provider to influence and control the delivery of the service within them. The challenge is often deciding which of a number of different components should be used in the Payment Mechanism, whether alone or in conjunction with each other.

Key Features of the Payment Mechanism

4.4.9 The key features of the Payment Mechanism can be summarised as follows:

- The local authority should make no payments to the service provider until the service is available
- Payment should be made only to the extent that the service is meeting the performance standards set out in the Output Specification and Contract
- The Payment Mechanism should provide for deductions to be made for sub-standard performance so that the service provider is worse off than if the required service had been delivered. Deductions should reflect the severity of failure, i.e. 'no service' should lead to 'no payment', but a minor failure should only cause at most a minor deduction, except in the case of prolonged and/or persistent failure, where a ratchet mechanism should be used to increase the level of deduction.

4.4.10 When drawing up the Output Specification and the associated outcomes, outputs, performance standards and Payment Mechanism, important factors that will have been taken into account that have an impact on the payment mechanism are:

- Service delivery itself must be capable of measurement
- Both quantity and quality of service are important, and both need to be capable of measurement
- Performance standards must be measurable, recordable, and reflect commercial reality.

4.4.11 There is also an important relationship between the Payment Mechanism and risk. The structure of the Payment Mechanism drives the allocation of risk between the local authority and the service provider, and as such must deliver value for money.

4.4.12 It is important that appropriate consideration is given to the Payment Mechanism at an early stage in the development of a project, and that payment parameters are developed that reflect commercial reality. As well as being an incentive for the service provider to deliver the outcomes and outputs that the local authority considers are important, the Payment Mechanism must also be fair, and support the long-term partnership.

4.4.13 Payment of the maximum possible level of the unitary charge should be conditional upon the satisfactory performance of the service provider. The Output Specification and Payment Mechanism should, therefore, set out:

- The level or target of performance required
- The means by which the local authority is able to monitor the service provider's performance against the required target
- The consequences for the service provider of a failure to meet the required level or target.

Setting the Performance Targets

4.4.14 In setting the performance targets for the Output Specification and Payment Mechanism, the local authority should focus on the standard of service it requires (ideally determined from a strategic service review or Best Value Review) and not, for example, on what it is familiar with. If the local authority or a third party is already providing the same type of service or part of the service, this may provide a benchmark from which the local authority is able to develop appropriate performance targets. However, it is important that the local authority is realistic with regard to the affordability of its proposals and how they relate to the quality of services currently being provided as part of the service.

4.4.15 In setting the performance targets, the local authority will need to define what is meant by the performance target. The definition will typically specify certain conditions that must be met if the service is to be treated as performing satisfactorily. As payment depends on the definition being met, the service provider and financiers will naturally be concerned that the definition consists of objective, measurable and reasonable criteria, so that it is clear to both parties whether or not those criteria have been satisfied. They will seek to establish that the unitary charge will not, save in circumstances which they have satisfied themselves are unlikely to occur, drop below a level that allows senior debt to be serviced and an equity return to be paid.

4.4.16 In considering what a reasonable performance level is, the local authority should decide what the optimum 100% performance standard would be and whether it is achievable and essential (taking into account the nature of the service), and to set the required standard in the Contract at this level.

4.4.17 In general terms, performance should be defined in as simple a way as possible. Complex definitions that require excessive monitoring should be avoided, although definitions may have to be very specific.

Prioritising Performance Standards

4.4.18 It may be appropriate for the local authority and other stakeholders to give a weighting to different aspects of the service or performance standards within the project according to their importance to overall service delivery. Failure to perform an aspect of the service results in a payment deduction that reflects the relevant weighting of that aspect, and subsequent days of sub-standard performance of the same aspect lead to progressively higher deductions.

Other payment mechanism considerations

4.4.19 The following are some other areas for the council to consider:

- Rectification periods
- When does the service commence?

- When does Sub-Standard Performance Commence?
- Restoration of Performance
- Contract Monitoring
- Planned Maintenance

4.5 Risk Allocation and transfer

Current Position

4.5.1 Currently risk identification and information has been produced for:

- Strategic risks
- Initial Project risks
- The Public/Private service model
- The partnering models

4.5.2 The Output Specification, by defining outputs, necessarily defines many of the risks that the bidders are being asked to take on. It is for the bidders to assemble the optimum means of delivering the services required and meeting the outputs specified, and they do this at their own risk of failure. If the services fail in some way, the local authority cannot be blamed if it has had no responsibility for suggesting how those services are to be provided, and has effective recourse through the Payment Mechanism.

4.5.3 For example, if a service provider installs an innovative aspect of service delivery (at perhaps higher cost than the local authority might have been able to afford on its own), it should be able to deliver the stated outputs more cost-effectively over the life of the Contract. Because the service provider has made this decision, not the local authority, it is the service provider that takes the consequences of running costs being greater than anticipated. No approval by the local authority, or agreement as to details, absolves the service provider from its contractual responsibility.

4.5.4 The Council would expect to develop the risk allocation and transfer using the Competitive dialogue process with the market. As a principle, the Council would wish to pass as much risk as possible across to the Partnership.

4.5.5 Further work on this is required as the Council progresses through the procurement process.

4.6 Risk Management

Introduction

4.6.1 The information below provides the detail of what is involved in risk management and a process on how to develop them, plus other information for the benefit of the Council.

The Risk Register

4.6.2 The risk register as stated above has been started, however more work is required. The following section defines the details of risk management.

4.6.3 All projects are subject to uncertainty and risk. The risk that project outcomes will not match project objectives needs to be recognised from the earliest stages of business planning, and suitable risk management responses developed.

4.6.4 The appraisal of options should include a thorough assessment of the risks associated with a project, with the basic principle being that value for money is most likely to be obtained when risk is assigned to the party best placed to manage that risk. The aim should be to achieve the optimum allocation of risk.

4.6.5 Different service delivery options will have different risks, for instance capital programmes costing more than forecast or over-running; operating costs exceeding forecasts; efficiency savings not being achieved; and third-party income not materialising.

4.6.6 Identifying and evaluating these risks at an early stage in the development of the project will allow a proper comparison of the costs and benefits of the various project and procurement options which, to be realistic, must include the expected value of the risks associated with that option. In quantifying the risks associated with each option, it must be assumed that each procurement option will deliver the same outputs and outcomes, as defined in the Output Specification, to enable a like-for-like comparison.

4.6.7 In general a risk register is best presented as a table for ease of reference and should contain the following information:

- Risk number (unique within register)
- Risk type
- Author (who raised it)
- Date identified
- Date last updated
- Description
- Likelihood
- Interdependencies with other sources of risk
- Expected impact
- Bearer of risk
- Countermeasures and
- Risk status and risk action status

Identifying the Project Risks

4.6.8 The first stage in this process should be to identify all of the risks associated with the delivery of the service or project and to record these on a 'Risk Register'. A separate Risk Register should be compiled for each of the project and procurement options under detailed consideration, as the profile of the risks will alter according to the specific details of the option. In preparing a Risk Register, it can be helpful to analyse the risks identified over the key stages of the project, such as development, design, build (or installation or refurbishment), financing and operations. Risk allocation columns should be used in the Register to indicate which party is expected to bear the risk under the various project and procurement options being appraised.

4.6.9 Table 18 below outlines the general types of risk

Table 18: Types of Risk

Risk Type	Brief description
Availability risk	The risk that the quantum of the service provided is less than that required under a contract.
Business risk	The risk that an organisation cannot meet its business imperatives.
Construction risk	The risk that the construction of physical assets is not completed on time, to budget and to specification
Decant risk	The risk arising in accommodation projects relating to the need to decant staff/ clients from one site to another

Risk Type	Brief description
Demand risk	The risk that demand for a service does not match the levels planned, projected or assumed. As the demand for a service may be partially controllable by the public body concerned, the risk to the public sector may be less than that perceived by the private sector.
Design risk	The risk that design cannot deliver the services at the required performance or quality standards.
Economic risk	Where the project outcomes are sensitive to economic influences. For example, where actual inflation differs from assumed inflation rates.
Environment risk	Where the nature of the project has a major impact on its adjacent area and there is a strong likelihood of objection from the general public.
Funding risk	Where project delays or changes in scope occur as a result of the availability of funding.
Legislative risk	The risk that changes in legislation increase costs. This can be sub-divided into general risks such as changes in corporate tax rates and specific ones which may affect a particular project.
Maintenance risk	The risk that the costs of keeping the assets in good condition vary from budget.
Occupancy risk	The risk that a property will remain untenanted – a form of demand risk.
Operational risk	The risk that operating costs vary from budget, that performance standards slip or that service cannot be provided.
Planning risk	The risk that the implementation of a project fails to adhere to the terms of planning permission or that detailed planning cannot be obtained, or if obtained, can only be implemented at costs greater than in the original budget
Policy risk	The risk of changes of policy direction not involving legislation.
Procurement risk	Where a contractor is engaged, risk can arise from the contract between the two parties, the capabilities of the contractor, and when a dispute occurs.
Project intelligence risk	Where the quality of initial project intelligence (e.g. preliminary site investigation) is likely to impact on the likelihood of unforeseen problems occurring.
Reputational Risk	The risk that there, will be an undermining of customer/ media perception of the organisations ability to fulfil its business requirements e.g. adverse publicity concerning an operational problem.

Risk Type	Brief description
Residual Value risk	The risk relating to the uncertainty of the value of physical assets at the end of the contract.
Technology risk	The risk that changes in technology result in services being provided using non-optimal technology
Volume risk	The risk that actual usage of the service varies from the level forecast.

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Quantifying the Risks

4.6.10 Once the risks have been identified and allocated to the party best able to manage those risks under each project and procurement option, the next stage is to quantify the material risks relevant to each project and procurement option so that an appropriate cost can be built into the financial models and options appraisal exercises.

4.6.11 The basis for calculating the impact of the risk will need to be documented and the assumptions tested. The quantification should show the likely cost to the project option of the risk materialising. This should be based on a technical assessment of the project risks, and be informed by data available from other service projects, from the local authority's historical experience, and from the market sounding exercise. In many cases the cost of the risk can be derived from an element of the project costs, multiplied by a factor. For example, the risk of capital cost overruns could be based on a factor of the costs of the capital investment, and the risk associated with energy provision may be related to the expected costs of energy supply.

4.6.12 There are various tools that can be used as part of this quantification exercise, such as probability analysis, risk impact analysis and Monte Carlo analysis, and the local authority should determine an approach that is relevant to local circumstances and the size and complexity of the project being developed.

Managing the risks of changing standards

4.6.14 The Output Specification needs to be drafted so that the emphasis is on the service provider keeping pace with changing standards. How the risks and rewards of such changes are reflected in the unitary charge should be part of competitive dialogue. The approach may well vary according to the nature of the risk. For example, some of these risks will fall within the generic definitions of general legislative risk, whilst others will have to be separately identified and catered for.

4.6.15 In determining how such risks should be managed, a balance needs to be struck between providing incentives to the service provider to continue providing the same service levels, and value for money. Sufficient incentives should be developed to encourage the absorption of any additional costs arising from changing standards, without transferring so much risk that the service provider will try to recover the possible costs indirectly, whether or not they occur.

4.6.16 In some instances, it may be better value for money to share the risks of changing standards. This may be done in a number of different ways, which include one or more of the following:

- A formula

- Capping the costs of change to both the local authority and the service provider
- Discussion at the time of the occurrence of the change within a pre-agreed framework
- Both the local authority and the service provider bearing the risks at different points in the Contract.

4.6.17 Whilst it is important to specify that services must be capable of improvement and modification in the future (such as following a CPA or Best Value Review), local authorities should take account of the fact that complete flexibility is likely to be very expensive and counter-productive.

Options to help manage risk

4.6.18 The following points are options to help the Council manage the risks and include:

- **Active risk management** – Effective management of risks involves:
  - identifying possible risks in advance and putting mechanisms in place to minimise the likelihood of their materialising with adverse effects
  - having processes in place to monitor risks, and access to reliable, up-to-date information about risks
  - the right balance of control in place to mitigate the adverse consequences of the risks, if they should materialise
  - decision-making processes supported by a framework of risk analysis and evaluation.
- **Early consultation** – Experience suggests that costs tend to increase as more requirements are identified. Early consultation will help to identify what those needs are and how they may be addressed.
- **Avoidance of irreversible decisions** – Where lead options involve irreversibility, a full assessment of costs should include the possibility of delay, allowing more time for investigation of alternative ways to achieve the objectives.
- **Pilot Studies** – Acquiring more information about risks affecting a project through pilots allows steps to be taken to mitigate either the adverse consequences of bad outcomes, or increase the benefits of good outcomes.
- **Design Flexibility** – Where future demand and relative prices are uncertain, it may be worth choosing a flexible design adaptable to future changes, rather than a design suited to only one particular outcome. For example, different types of fuel can be used to fire a dual fired boiler, depending on future relative prices of alternative fuels. Breaking a project into stages, with successive review points at which the project could be stopped or changed, can also increase flexibility.
- **Precautionary Principle** – Precautionary action can be taken to mitigate a perceived risk. The precautionary principle states that because some outcomes are so bad, even though they may be very unlikely, precautionary action is justified. In cases where such risks have been identified, they should be drawn to the attention of senior management and expert advice sought.
- **Procurement/contractual** – risk can be contractually transferred to other parties and maintained through good contractual relationships, both formal and informal. Insurance is the most obvious example of risk transfer. The main text of this annex provides further information about the types of risk that can, and often are, transferred.
- **Making less use of leading edge technology** – If complex technology is involved, alternative, simpler methods should also be considered, especially if these reduce

risk considerably whilst providing many of the benefits of the option involving leading edge technology.

- **Reinstate, or develop different options** – Following the risk analysis, the appraiser may want to reinstate or options, or develop alternative ones that are either less inherently risky or deal with the risks more efficiently.
- **Abandon proposal** – Finally, the proposal may be so risky that, whatever option is considered, it has to be abandoned.

Optimism Bias

4.6.19 Optimism bias is the demonstrated systematic tendency for appraisers to be over-optimistic about key project parameters. It must be accounted for explicitly in all appraisals, and can arise in relation to:

- Capital costs
- Works duration
- Operating costs
- Under delivery of benefits

4.7 Staff Transfer
Introduction

4.7.1 In line with case law**, The House of Lords in *Celtec –v- Astley and others [2006] UKHL 29.*** , and on advice given to the City Council in relation to the recent Strategic Services Partnership the secondment model could be regarded as contravening an enactment (namely TUPE), be *Wednesbury* unreasonable and therefore may need to be reported by the Monitoring Officer as a breach of Section 5 Local Government and Housing Act 1989 with all that flows from that.

4.7.2 Nevertheless, there are basically three potential employment models if transfer is required.

- Transfer to a new employer under the TUPE regulations
- Secondment in which staff remain employed by the public sector.
- Staff Choice

Definitions

TUPE

4.7.3 TUPE is the name given to the Transfer of Undertakings (Protection of Employment) Regulations 1981 that were introduced to implement the European Acquired Rights Directive. In essence, TUPE provides protection for employees in the event of a transfer of a service from one employer (in this case the City Council) to another (the successful Bidder). The protection operates by putting the new employer in the same position as the old employer in terms of most employment rights and obligations (such as contractual issues, continuity of employment, unfair dismissal rights, discrimination claims, personal injury claims etc). In other words, the employee's employment contract is deemed to have always been between the employee and the new employer.

4.7.4 In brief, under the TUPE model, affected employees are transferred to the partnership and as such, become employees of that organisation, on existing terms and

conditions of service and continuity of service.

Secondment

4.7.5 Under secondment, the staff remain Local Authority employees although they continue to work on the services under the day-to-day management of the successful Bidder. If the successful Bidder no longer requires any of them, they would return to the City Council to their substantive posts if still available or, if not, for redeployment if available or redundancy

4.7.6 Generally secondments are for relatively short periods of time. However certain authorities and contractors have in the past used long-term secondment arrangements as an alternative to TUPE transfers. These arrangements may be seen to benefit all the relevant stakeholders and may be agreed by all. By ensuring that control of the workforce remained with the City Council and, so long as the workforce was committed to secondment and nobody challenged their status as a secondee, the arrangement was unlikely to be questioned. If there is no dispute between the parties then (the argument goes) the law will not usually get involved.

Staff Choice Model

4.7.7 In relation to the mechanics of the staff choice model, each individual employee would have to choose for him or herself whether to transfer under TUPE or to object to the transfer and thereby terminate their existing employment contract at the date when the transfer took effect. It is entirely possible that some staff would choose to transfer under TUPE and some would choose not to transfer but would accept re-engagement and secondment.

4.7.8 The City Council would offer re-engagement on the existing terms and conditions to each employee who chose not to transfer. The job offered would be the existing post, to be seconded to work on the SSP Services under the day to day management of the successful contractor.

4.7.9 So, each employee would have to be consulted individually, at least in writing. The recognised Trade Unions could not make a decision on behalf of all the affected staff, nor on behalf of all the affected staff who are their members.

4.7.10 In practice, each employee would have to be provided with a form to complete and confirm whether or not they would transfer under TUPE. Each employee who confirmed that they would not transfer would then have to be issued with, and accept, a new offer of employment.

4.7.11 The Regulations do not require the objection to be in writing but the City Council could make the offer of re-engagement subject to receiving written confirmation that they would not transfer under TUPE before a specific date.

4.7.12 It is essential to any lawful decision to follow secondment that there should have been a proper consideration of the desirability and practicability of the proposals and that an informed and reasonable judgment should be made about whether any disadvantages are outweighed by perceived industrial relations advantages.

Advantages and Disadvantages of the TUPE and Secondment employment models

4.7.13 Tables 19 and 20 set out a comparison of the advantages and disadvantages of both TUPE and Secondment employment models

Table 19: TUPE employment mode

TUPE	
Advantages	**Disadvantages**
• Council's liability for the employees ends immediately upon the transfer. Council may, if it wishes indemnify the Joint Venture Company (JVC) for any liabilities incurred before the transfer date, but it is not obliged to do so. • Duty to inform and consult with transferring employees/trade unions • Legally certain. • Continuous employment with old employer will transfer. • Liabilities arising in connection with employment relationship can be transferred to new employer. • Statutory rights and liabilities will transfer, and the JVC may inherent liability for breaches of employee's rights under Sex Discrimination Act 1975, Race Relations Act 1976 and Disability Discrimination Act 1995. • Any collective agreement to which transferring employee is party will also transfer, unless and until the Joint Venture Company ends such agreement. • Liability for any course of action begun (for example disciplinary action) will transfer • Any employee dismissed by reason of the transfer will be able to claim, with limited exception, unfair dismissal. • Greater clarity over who is responsible for poor performance • Risk associated with pay increases over and above agreed indexation arrangements transferred to the Partner • Changes may be easier for the partner to implement as they will have greater freedom of approach. • The Partner will feel more confident in its ability to manage service delivery risk in a TUPE environment as it will employ the	• If the project is for a finite period, there is the difficulty of what happens to those employees at the end of the term. • Pensions are currently excluded from the scope of TUPE. Can mitigate this by requesting Admitted Body Status. • Changes cannot be made to the terms and conditions of TUPE employees and so the JVC will bear these costs until natural wastage occurs, and will seek recovery from public sector. • Council may lose employees who also work outside the undertaking at least part of the time. • Council will loose all management control over the employees and so cannot recruit, select, promote, discipline or dismiss any of the employees after the transfer date. But the JVC shall take on all responsibility for the employees. • It is possible there will be more Union and staff resistance to this model which may affect employment relations. • Potentially more difficulty in retaining staff during the transition period (subsequently bidders current contracts have noted increased attraction levels). • Intellectual Property Rights (IPR) may belong to the Partner not the authority although this risk could be mitigated by the Partner granting the authority licences to use IPR, for example on exit.

TUPE	
Advantages	**Disadvantages**
staff. • The Partner will have responsibility for training, recruitment to replace staff who leave etc so they bear clear contractual responsibility for any deficit in service levels. • Potential staffing costs to the authority are known (i.e. no potential redundancy / redeployment costs from the Strategic Service Partnership). • Defined staff group transfers under the same employment arrangement providing clarity on employer / employee relationship and management responsibilities at same point in time. Secondment leaves considerable scope for dispute as to where responsibilities for deficits in service lie. TUPE offers greater, though not complete, clarity. • Clarity of employment relations and ownership responsibilities facilitates a smaller client side on HR advisory and support issues • Responsibility for provision of information about the workforce on exit and liability for any omissions in such information would fall on the Partner.	

Secondment Model	
Advantages	**Disadvantages**
• Seconded staff retain their options for career development within Council. • Staff can easily remain in the Local Government Pension Scheme • Generally preferred option for Trade Unions. Less risk of industrial action. • Employees retain their public sector employed status • Some bidders may price the secondment option more cheaply than the TUPE option. This price differential can be because the employment risks and liabilities remain with the Council i.e. SSP employees remain on the authorities terms & conditions • Employment and staff relations may be perceived to be easier if a secondment model is adopted. This may be illusory as in practice the authority may not be in the best position to affect relations between staff and Partner. • It may be an easier employment model to implement in respect of employment relations • Staff retention may be encouraged through secondment. • Staff are familiar with the authorities practices for proposing any changes to terms and conditions. • Potentially easier staff relations and less anxiety about potential transfer. • All Intellectual Property Rights (IPR) and knowledge remains with the Council. • The Local authority retains flexibility and capacity • The local authorities corporate policies implemented • It is much easier to transfer employees back and untangle the employment relationship if the contract or the JVC falls apart (e.g. change of partner company ownership). Under TUPE this would be a more complex process	• The Cabinet Office's guidance "Staff Transfers in the Public Sector" expects TUPE to be used by the Public Sector so Council may find it has to justify any decision to subvert the operation of TUPE. • There can be no guarantees that all of the employees will agree to a secondment model and so some staff members may be subject to TUPE in any event, thus leading to a two–tier system being operated. • Seconded employees could subsequently argue that the length of the secondment is such that they become employees of the Joint Venture Company (JVC). • Council will remain legally responsible for anything that happens to the employees; notwithstanding they are under the day to day control of the JVC. Therefore Council will need to seek indemnities. • Having a mixture of full time employees and seconded staff within the JVC could lead to management difficulties as well as potential legal claims for equal pay or otherwise. • Recruitment of new employees will need to be carefully considered. Under TUPE all responsibility rests with the JVC. • The JVC may wish to utilise seconded staff for non-Council work which has legal and logistical problems. • Complex arrangements need to be put in place, returning of staff etc. • The cost of redeploying, or making redundant returning staff remains with the Council • The Local Authority may have to retain more infrastructure to support the employees retained – such as HR and other support services. • Performance and financial risks may to some extent remain with the Council • There will be a difference in identity between the body which employs a large number of the staff (i.e. the authority) and the body which is responsible for managing those staff (i.e. the Partner). This raises significant practical problems such as confusion over management

	responsibilities and no clear accountability. • Changes may need to be implemented more slowly as must be carried out in accordance with the authorities Standing Orders, scheme of delegations etc. • The Partner is likely to seek indemnities and other contractual protections from the authority during the negotiations so that it obtains appropriate relief if it is unable to achieve service standards due to staff action/default i.e. industrial action, persistent poor performance, absence, training deficit, delays in recruitment etc. The partner is likely to argue that as it is not the employer it is unable to manage these risks. By contrast under a TUPE model, this risk would be passed to the Partner. • Individuals could seek to terminate the secondment arrangement and return to the authority. As their substantive posts would no longer exist within the authority (but form part of the services being performed by the Partner) unless the individual could be re-deployed they would generally face redundancy. The authority would bear such redundancy risks and costs and could not predict or control when such situations would arise. • The authority would need to ensure as employer that its policies and procedures are being properly implemented by the Partner on a day-to-day basis. Any changes in policy which the authority wanted to introduce generally might have to be agreed with Partner or be introduced via Change Control, with any relevant financial adjustments. Under a TUPE model this would not be required as employer liability would be transferred. • On any re-let of the contract if the local authority does not bring the service back in-house, it is difficult to assess whether potential successors to the Partner would view a seconded workforce as attractive or unattractive. Whereas a TUPE'd workforce would be the norm in such circumstances and could be viewed as commercially neutral.

Summary

4.7.14 It is acknowledged that there are considerable impacts and considerations for staff in considering the decision. However, the project must act in the best interests of the City Council as a whole, ensuring value for money and find an appropriate balance between staff and community considerations.

4.7.15 This report recognises that there are advantages and disadvantages to both employment models however the primary consideration is the legality and practicality of implementing the secondment or staff choice model. This consideration, in addition to the many other advantages of a TUPE transfer means that the TUPE employment model is the recommended model. The key reasons include:

- Legal position – TUPE applies as a matter of law. Conversely, as in 4.7.1, secondment is a relatively new concept and untested in law over a significant period of time. An individual can challenge the secondment approach on the basis that they were being denied their legal right to a TUPE transfer – this could put the whole agreement at risk.
- Impact – The primary 'soft' benefit of a Partnership is the organisational cultural change it will deliver and the positive outcomes of the cultural change on operations. The secondment or staff choice model is not conducive to delivering cultural change.
- Risk – Secondment represents poor risk management for the council in that, as the employer, it remains responsible for any action taken by the partnership and has liability for any employment related issues e.g. tribunal claims, redundancy payments, redeployment and performance management
- Cost – As a result of the above, the Council would have to operate a "shadow" management board (including dedicated HR support) in order to undertake any formal actions that are required by the partnership that relate to the employment relationship
- Protection of terms and conditions – an important part of the negotiations both to date and in the future, will be around securing protection for employment related terms and conditions, where necessary beyond that offered by TUPE, which can be built into the contract and into an agreement between the Council, and the trade unions.
- The need for clarity – TUPE offers the most certainty to both the Council and any Partner in terms of staff transfer and the risks associated with this.

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