

## **Appendix 1**

### Memorandum of Understanding between Oxford City Council and the Oxford Direct Services group of companies

#### **Background**

Oxford City Council has set up the group of companies collectively trading under the name of Oxford Direct Services. The companies are Local Authority Trading Companies. They are Limited by Shares all owned by the Council. That means that they are wholly owned by the Council and their primary reason for existence is to serve the requirements of the Council

Whilst this document has no legal status - that is set out in the Memoranda and Articles of the Companies, the Shareholder Agreement and the contracts between the Council and the companies, it does set out in plain language the intention behind those documents with the aim to ensure that all engaged in the relations between the parties are clear.

The company structure is in two parts.

A "Teckal" exempt arm that will trade primarily with the Council, without the need for public procurement, to carry out statutory functions such as domestic waste collections and services that support the functions of the Council for example repairs and maintenance of the council's housing stock. This arm may carry out external trading relating to those services up to the limits proscribed in the Public Contracts Regulations 2015. This company will employ all the staff and will through a services contract provide labour to the trading arm

An arm that trades exclusively with third parties which is not bound by Public Law requirements.

At inception over 80% of the turnover of the group of companies will be with the Council.

#### **Purpose of setting up ODS**

The Council has been using surplus capacity in its direct services to earn external income to contribute to overheads for some time. It has been found that the Council services are valued and competitive in the market place. In light of this the Council is seeking to exploit this opportunity to reduce its costs and raise income.

Therefore the purpose of the ODS group of companies is to reduce expenditure by the Council by

- Sustain and grow an income stream back to the Council
- Drive further efficiencies
- Meet the requirements of the Local Government Act 2003 in relation to trading.
- Establish a platform for growth with the same opportunities as other commercial companies
- Maintain and grow good local employment opportunities

The distribution of profit between the company and the Council is set out in the shareholder agreement and reflects the level of risk that the Council wants to transfer to the companies. Risk transfer to the Teckal arm will be relatively small reflecting the close links with the Council whereas the Trading arm will carry more of its own risk..

These various elements have been modelled and the optimum balance to deliver the outcomes set out above is summarised as:-

- the focus will be to deliver the MTFP requirement
- There is an expectation that the current MTFP estimates can be exceeded by the company structure and this should be pursued
- The council through its role as shareholder will want influence over the core terms and conditions of employment
- The expectation is that a relatively low level of profit will be retained in the Teckal company to cover risk and fund investment
- The council is seeking a low level of risk transfer to the Teckal company
- The trading company will retain profit commensurate with the risk transferred.
- There will be a low level of control over the commercial activities of the trading company

### **Length of Relationship**

There is a balance to be struck between the commercial interests of the company and those of the Council to ensure that there is a truly symbiotic positive enduring relationship between the parties. Some local authorities have set up LATCs with the aim of “weaning” the direct service aim off being reliant on the council’s services and exposing those services to competition. This is not the intention in this case. The intention is to continue to build on that upward spiral of good, value for money services, being competitive, earning income and supporting the activities of the council.

The council and company will therefore enter into long term contracts for services on the same term length for

- The provision of services to the Council
- The purchase by the company of support services from the Council
- Leases for depots and plant
- Loans from the Council to the Company to support the development of the Company.

All of these arrangements will reflect the best interests of the shareholder, the Council and be compliant with “State Aid” requirements but will also ensure that the company is viable and an attractive proposition for third parties to do business with.

### **Initial Basis of charges**

At the point of inception charges for services to the Council will essentially be based on the budgeted costs subject to any previous agreements as to efficiency programmes currently in place. For example in building maintenance.

Subject to the detailed agreements on risk sharing those costs will be subject to

- Pay inflation
- Inflation in services and charges from the Council to the Contractor to support the provision of services
- Inflation in respect of materials
- Changes in policy imposed by the council
- Changes in service levels required by either party
- Efficiencies achieved in the provision of services by either party

These charges and costs may be varied as part of the overall package to ensure that the company set up is profitable, the arrangements are tax efficient and there is sufficient retained profit to cover risks transferred to the company and demonstrate a viable company to both potential customers and suppliers alike.

Mechanisms to incentivise cost reduction by both the company in providing services to the Council and vice versa will be reflected in the documentation between the Council and the company.

### **Risk sharing**

There will be a risk sharing agreement as part of the contractual arrangements between the Council and the Contractor. The risk sharing agreement will be based on the identification of key risks to cost and an apportionment ownership of that risk to the party best able to manage that risk. Risks retained by the Company will be reflected in the profits retained by the company and the view taken by its Directors on the declaration of dividend.

The key risks identified are:-

- Fuel costs
- Pension costs
- Policy requirements imposed on the company by the Council through its shareholder representatives
- Pay costs
- Utilities
- Repairs and Maintenance

Some of these risks are associated only with the Teckal company and the services contract with the council.

### **Assets**

Assets will be retained by the council and the the company will be charged market rate for leases for property and finance leases for plant and equipment

### **Customer book and goodwill**

The company will be charged the market rate on a revenue basis for the business transferred to the company.

### **Review**

Whilst the Council has been trading for some time the new arrangements will provide new ways of accounting and managing cost.

It inception services both direct and support will be largely as there are now and charged on a similar basis.

The Council and the company will be committed to take all opportunities achieve efficiencies from the status quo.

Over time experience is likely to demonstrate new and better ways of working and to ensure that a holistic review is taken of the opportunities a substantial review will be undertaken no later than year three which will renew a resetting of the base. The review will cover but will not be restricted to:-

- The services required by the council
- The cost of those services charged by the company
- The services required by the company
- The costs of those services
- Review of risk sharing agreement
- Review of dividend distribution

## Headline draft risk sharing agreement

| Item  | Risk / reward dimensions  |
|---|---|
| Fuel  | Company manages in year risk up to 5%, up and downward movement in price. Council thereafter. Trading company covers entire risk  |
| Utilities   | Lies with Council – on the basis the Council manages the contracts & large procurement benefit in place. Contract will require co-operation to achieve 3% per annum reduction in utility costs. Both operations.  |
| Materials   | As set out in MTFP, Risk sits with Client. Teckal only. Trading company manages its own risks   |
| Salaries  | Reflecting the adoption of the council's pay scheme the remains a client risk. Teckal only.   |
| Pay mechanism for default                               | Same for services in both directions  |
| Aged debt associated with trading activity.             | Existing debt at date of transfer stays with council.<br>Newer debt – 50/50 split (at the point of being uncollectable) i.e. main responsibility lies with the Council on the assumption there is an agreed process and that is adhered to by both sides. If the company overrides that process the associated debt transfers to the company. Trading company only. |
| Block payments (e.g. responsive repairs)                | +/- 5% of average spend over preceding 3 years sits with company. Teckal only.  |
| Delivering MTFP (over / under)                          | MTFP as agreed with the company is guaranteed.<br>Surplus distribution in line with dividend policy. Both   |
| Pensions  | Deficit at transfer remains with Council. On going payments with companies. Both  |
| Recycling credits (and other statutory related incomes) | Stays with Council. Teckal only   |
| New Council policies                                    | Costed and additional charges made by the company. Both   |
| Repairs and Maintenance                                 | With Council as it manages all such functions. Total costs reflected in the lease charges. Trading company to cover that part that relates to trading activity.   |

## **Outline of proposed Dividend Policy**

- 1) Deliver the MTFP expectation
- 2) Cover unbudgeted costs/risks in the group
- 3) In year spending on enhancements of assets to reduce cost to council and build future business agreed with the Council
- 4) Dividend –in favour of council on the assumption 1,2 & 3 are covered first