

## **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 prescribed 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, generated through efficiencies, 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 and will:

- Sustain and grow an income stream back to the Council
- Drive further efficiencies
- Reduce costs through spreading overheads

- 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, through reduced costs, rebates, payments and dividend
- 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

### **Returning Value to the Council**

ODS prides itself on delivering high quality and market equivalent productivity which together with an employment ethos of fair pay including paying the Oxford Living Wage, good pensions and benefits add up to a powerful combination of being good for our Shareholder, good for our customers, good for our workforce and good for Oxford – with money being retained within the local economy and Shareholder profits reinvested in the city.

ODS will continue to deliver value to the Council by:

- provision of high quality, cost effective services and in doing so supporting the vision of ‘building a world class city for everyone’
- sustaining and growing local employment opportunities
- provision of a large labour force able to respond quickly to emergencies
- supporting the local economy through the multiplier effect of turnover
- contributing to environmental improvements through operational practices
- offering training and apprenticeship opportunities

- ensuring provision of progressive employment policies and practices, good terms and conditions of employment for circa 700 people all receiving at least the Oxford Living Wage
- Continuing adoption and promotion of the vision, values and behaviours imparted from our Shareholder

### **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” their direct service arm 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.

The contract length will be for 20 years with the potential for a 5 year extension.

### **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**

Property assets will be retained by the council and the company will be charged market rate for leases, for plant and equipment the Council will fund their purchase through loans but the company will be responsible for repair and maintenance and will take ownership.

### **Customer book and goodwill**

As the financial interests of the company and council are so close the company will not be charged for the notional value of the business transferred. Instead the council will achieve value through rebates, cost reductions and dividend.

### **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	Teckal 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 it own risks
Salaries	Reflecting the adoption of the council's pay scheme this remains a council risk but is re-charged to the trading company
Pay mechanism for default	The focus will be on service improvement and innovation with dispute resolution mechanisms, As such there will be no default procedures
Aged debt associated with trading activity.	Existing debt at date of transfer stays with council. 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 proceeding 3 years sits with company. Teckal only.
Delivering MTFP (over / under)	MTFP as agreed with the company is guaranteed. 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 to leased property	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.
Income Risk	
Those sitting with council	Remain with the council.
Those sitting with company	Remain with the company
Car park income	The parties will agree a base income target for the year. An incentive agreement will be entered into. Any income over the base will be shared with the company as per the incentive scheme.
Redundancy	
The council and the companies in agreeing the MTFP, the Business Plans and workforce plans will work to smooth out workforce requirements so that there are no unexpected drops in demand that cannot be managed out.	
Client Change	Client covers – applies to Council to company and vice versa
Lost commercial business	Trading company –company to hold contingency to cover this.

Change in law etc.	Teckal covered by Council, trading arm by itself
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### **Outline of proposed Dividend Policy –**

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

**Inter company transactions** – the companies being related in the same group and it being reflected in their articles can agree to do anything lawful that is in the interests of their shareholders.

### **Where staff tupe to**

We are setting up the Teckal co in effect to be the Hold co and employ the staff. Staff then charged out to the Trading arm. 2 issues

- The cost of the staff charged or at least the profit needs to be counted in the 20% turnover of the teckal. This is okay for MTFP but breaks down if expand further. Longer term fix is to get HMRC approval to have a grouped payroll. We are advised that this is possible and not unusual. The problem with doing this now is that getting payroll up and running is the critical path. This would delay further. .
- We need to register the Teckal as an employment agency and deal with the minimal bureaucracy around that.

We are settled on this as day one approach. We will develop the dual payroll and move over commercial activity to the trading arm as and when appropriate and desirable

### **Choice and flexibility in terms and conditions for new employees hired to the company after transfer:**

The existing standard terms and conditions, including pension arrangements will continue, including for new starters. The company will work with the trade unions to explore choice and flexibility in terms and conditions for new employees. Discussions would need to ensure that a two-tier workforce is avoided in that a different package is valued by its recipients as broadly equivalent to the standard package. This may include offering a choice to new hires. Trade union endorsement to any changes will be sought. As a reserved matter any proposals need to be agreed by the Shareholder

### **What is “in” the trading company?**

The only thing that will be in the trading arm at inception is the commercial waste service. As the business grows this will need to be reviewed to maintain the Teckal status.

### **Provision of support services**

Support services will continue to be provided by the council. This arrangement will be reflected in the services contract. However, these services will need to adapt to the new commercial realities facing the companies. The MD in consultation with the board if required will procure such commercial advice that is not available from the Council or its contractors e.g. tax advisors.

#### **Whether income goes to co. or council**

We have taken the view that we are transferring the services to build the business rather than simply outsourcing in that case grounds maintenance.

In some cases, income is going straight to Council i.e. car parks, charges for statutory services and income e.g. recycling credits. The income risk for these sits with the client.

Remaining income will flow to the company who is running the service and taking the income risks.

#### **Pension**

The company will be granted designated body status so that it can continue to provide LGPS. The company will account for the pension on a defined contribution basis. This means that the contract will set out the cash limits of the expectations of the company and that all deficits past, future and on close of the contract will sit with the council. A tri-partite contract between the council the company and the Pension Authority will be entered into reflecting this.

#### **Pay mechanism in particular default**

The contracts will focus on arrangements to rectify errors and omissions in service deliver developing the partnership contract approach. Therefore there will be no default, penalty mechanism at this stage. If considered necessary and appropriate it will be added at the contract review stage.