Future Cleansing Contract Service Delivery Options

Report for Arun District Council

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1 Introduction

Arun District Council (the Council) engaged Ricardo Energy & Environment to undertake a review of the Council's current Cleansing Services, namely street cleansing and waste and recycling services (the Services) currently provided by Biffa. The current Contract will expire in February 2023. This review explores the options for the delivery of the services when the current Contract expires. The options under consideration are:

- Extending the current Contract with Biffa
- Procuring a new Contract for the provision of the Cleansing Services through a procurement exercise
- Bringing the Cleansing Services in-house (as a DSO – Direct Services Operation)
- Utilising a 'Teckal' approach (possibly through Norse Commercial Services Ltd (Norse Commercial Services are a Teckal company wholly owned by Norfolk CC Norse Commercial Services (part of the Norse Group, which is wholly owned by Norfolk County Council)) to provide the Cleansing Services.

The review thus looks to illustrate the risks, benefits and outline costs associated with delivering the Services either in-house through a DSO, by setting up a Local Authority Trading Company (LATCo) which would then be contracted by the Council to provide services back to the Council via a Service Level Agreement, or through the procurement of an outsourced Contract.

It should be noted that the procurement of an outsourced Contract(s) would require a full competitive procurement exercise in line with the public procurement regulations.

However, in the case of moving to a DSO, there is no procurement requirement. In the case of a LATCo, the Council would be able to apply the 'Teckal' exemption which allows the authority to transfer the Services to the LATCo without the requirement for a procurement exercise.

Extending the Biffa Contract

The current marketplace for contracted out services may lead to an ineffective procurement exercise. A combination of an evolving market, the uncertainty created by the Environment Act and the Resource & Waste Strategy, staffing constraints, rising interest rates and inflation and international supply line issues may limit the number of bidders, leading to an inefficient or expensive procurement. Biffa have been asked to provide a pricing schedule for an extension; this exercise includes costings for current service provision and alternative collection methodologies (reflecting both the Council's ambitions and the potential changes to statutory collection services proposed by the government).

The process of extending the Contract provides certainty of service levels and cost. No additional procurement costs are required, the commitment of internal resources (a procurement or transition to a DSO or LATCo requires substantial resource commitment from teams including Waste, Finance, Legal, Procurement, HR and IT) are minimised and the potential disruption to services during the transition to a different service provider are avoided. The uncertainty of government funding for waste management (with potential New Burdens Funding for the introduction of food waste collections and Extended Producer Responsibility Funding for recycling collection) makes it difficult to provide certainty of service requirements (in terms of number and type of vehicles, collection frequencies and staffing numbers) and thus makes financial planning, for potential bidders or for the Council, extremely challenging over the next three years; in the case of Outsourcing a new Contract, this is likely to lead to risk pricing. The three-year extension period will provide the benefit of postponing the choice of service delivery options sufficiently for the current uncertainties surrounding service provision to be either resolved or more controllable, and government requirements and associated funding confirmed.

It should be noted that this report does not intend to provide specialist procurement advice, which is the function of the Council's procurement advisors, but advises on the deliverability/operational considerations of this option in the context of the current marketplace and legislative developments. This is summarised following more detailed considerations of the alternative options.

Outsourcing

The process of outsourcing the Services involves the procurement of a third party to deliver the Services on behalf of the Council via a Contract. This would conventionally involve a Contract between the council and the service provider appointed following a competitive procurement exercise in line with the public procurement regulations. As with the current Contract, the Council would have no involvement in the day-to-day running of the organisation (or its ownership or governance structures), but would be able to influence the way the service is run through:

- The terms of the Contract
- The Specifications and Method Statements incorporated in the Contract documentation
- The payment mechanism, incorporating any financial mechanisms for performance payment
- Contract monitoring, including a regular monitoring and review process, including assessment of KPIs and other performance indicators

Pension arrangements would be the responsibility of the private sector provider. However, any qualifying staff from the current contractors would transfer to the new contractor under the Transfer of Undertakings (Protection of Employment) (TUPE) Regulations, maintaining the same terms and conditions, including pension arrangements.

It may also be the case that some Biffa staff have retained their LGPS arrangements having originally transferred from the public sector. The Fair Deal policy 2013 gave public sector employees who were transferred from the Council to external contractors under TUPE the right to remain in the same pension arrangement as before; if they have retained their membership of the LGPS, they will thus be entitled to the accrued benefits and continued membership should they transfer to a private sector contractor.

Similarly, where Biffa employees are currently in a pension scheme, TUPE requires that they are offered a similar provision by the employer they transfer to; this is complicated by the number of schemes available.

DSO

Bringing the Services back in-house as a Direct Services Organisation (DSO) involves the Council employing and managing all staff involved in the delivery of the Services. The Council would also manage the vehicle fleet and organise the workload as well as undertaking the 'client' role and engaging with the public. With some in-house arrangements a 'client / contractor' split exists to clarify roles, but this is not essential and may add costs. Any staff joining the Council would be entitled to membership of the Local Government Pension Scheme (LGPS).

LATCo / Teckal

The 'Teckal' approach involves the Council setting up a Local Authority Trading Company (LATCo), which would then be contracted by the Council to provide services back to the Council via a contractual arrangement incorporating a Service Level Agreement. The Council may decide to apply the 'Teckal' exemption which allows the authority to establish a LATCo without the requirement for a procurement exercise. This is codified in the Public Contracts Regulations 2015, and in summary requires the Council to "control the vehicle as if it were an internal department, with there being no direct private share or ownership participation in the company (this is known as the control test) and for more than 80% of the LATCo's activities to be with its 'parent' Council (this is known as the function test)"[1].

[1] Government Guidance webpage

A key difference between the Teckal arrangement and the in-house arrangement is the terms and conditions on which staff are employed. As the LATCo would be a separate company, the qualifying staff from the current contractors would transfer to the LATCo under TUPE, maintaining the same terms and conditions, including pension arrangements. The same conditions would apply to any staff joining a LATCo from the Council (i.e current DSO staff).

The key advantages of the LATCo and DSO approaches are the direct control of the Services, through direct management (DSO) or through a Council appointed Board (LATCo). This enables the Services to be revised to adapt to changing needs, priorities, circumstances and policy or legislative developments.

Summary Conclusions: Overall Costs

The primary factors leading to differences between the costs of each service delivery option are:

- The private sector will include both corporate overheads and a profit margin in their tendered costs; this is generally in the region of 10% of Contract costs. This adds an additional cost burden to the services but does provide access to external expertise and contingency.
- No equivalent profit margin is required for the DSO option.
- The requirement for a limited company to achieve a profit means that a LATCo must be funded appropriately, and cannot be run at a loss.
- Pension costs will be the primary driver of differing cost implications for each of the delivery options. The Services are all heavily labour intensive; as a result, the higher level of LGPS pension contributions adds significantly to the DSO costs for direct labour and to the support services provided by the Council:
- Pension costs are modelled at 3% and NI at current rates for Contracted Out and LATCo;
- Pension costs are modelled at 20% and NI at current rates for DSO;
- The cost of support services (wider support from HR, IT, H&S, Finance etc departments) should be included for the DSO option, and depending on the structure, may need to be included for the LATCo option.

As indicated, the option of extending the current Biffa Contract provides certainty of cost, maintains current resource levels, minimises risk pricing and provides an opportunity for a greater degree of certainty regarding both service change and increased government funding for the services.

Summary Conclusions: Operational / Back Office Costs

If the Council considers the LATCo or DSO approach, it is important to assess the relative operational costs of 'managing' the service under each of the service delivery options.

At present, for the Services provided by Biffa, the Council's costs are concerned with the monitoring of the contractor's activities, the management of the payments to the contractor and the appropriate reporting of Contract outcomes (KPIs, statutory reporting requirements, reports to senior officers and Members etc).

The Contractor is responsible for the operational activities involved in carrying out the Services as required by the Specifications, in line with the Terms & Conditions and the Conditions of Contract. The Contractor is thus responsible for the costs of providing appropriate resources to facilitate the delivery of the Services. Operational issues will be dealt with by a dedicated local management team. However, the Contractor will utilise the benefits of being part of a large organisation (probably with multiple contracts across multiple local authorities) to utilise corporate or regional 'administration' staff, covering areas such as IT, HR, H&S, payroll, finance, industrial relations, maintenance & repair and other specialisms. This benefit also provides the capability to access equipment, staff and experience from other contracts in the case of emergencies, industrial disputes and during the mobilisation process.

Should the Council opt to re-procure an external contractor or extend the current Biffa Contract, these arrangements will remain unchanged:

- The Council's current internal costs associated with the Services remain unchanged if the Services are re-tendered;
- The Contractor's internal costs are incorporated within the annual contract cost of each of the services provided to the Council.

Should the Council opt to transfer the Services to a Council-owned LATCo or DSO, the management arrangements would be fundamentally altered.

In the first instance, the outgoing Contractor's staff may choose not to transfer to the LATCo or DSO. This could lead to a critical gap in skills and capacity, and thus recruitment of appropriately qualified and experienced staff to replicate the current management skills would be an urgent matter for consideration.

Neither the LATCo nor DSO will be able to take advantage of the Contractor's 'corporate' team of specialist staff to deal with issues such as IT, HR, H&S, payroll, finance, industrial relations, maintenance & repair. There would also be a requirement for staff to deal with waste-specific issues of procurement (vehicles, containers and equipment), licensing, environmental legislation, strategic development and industry-specific standards.

Summary Conclusions: Transition costs

As with all changes of service provider, the transition from the current service provider to either a different private sector service provider, a DSO or a LATCo requires appropriate resourcing and expertise.

This will include a range of operational and administrative requirements: Information and Communications Technology (ICT) integration; new service implementation; communications and public engagement, operational matters such as confirmation of round routes, obtaining keys and access codes and ensuring service continuity; TUPE; progress updates, and vehicle and depot arrangements etc.

Should the Services be outsourced, the new service provider will allocate a dedicated team to this exercise as a dedicated project. The cost of this will be incorporated in the service provider's tendered price. The transition team will commence this process several months in advance of the transition, ensuring the process is efficiently managed.

Similarly, either the LATCo or DSO would need a dedicated team to mobilise the service. The Council or the LATCo would thus need to procure or provide the expertise necessary to run the full range of the Services, and would almost certainly have to either rely on the capability of those managerial/supervisory roles which would be expected to transfer to the LATCo or DSO under TUPE regulations or on buying-in such expertise.

The timescale demands that this dedicated team would need to be in place in advance of the transition from the current contractor. This is to ensure familiarity with the key operational aspects of the Services in a manner which ensures the appropriate capacity and expertise required to manage the transition and mobilisation process.

These issues are postponed should the current Biffa Contract be extended, providing a manageable timescale for these issues to be considered in depth.

2 Risk

A key element of the consideration of Service Delivery options is the assessment of risk. This may be considered in terms of the risk of poor performance of the Services in terms of financial impacts, the quality of the Services provided, the contingency within the Services in terms of managing adverse conditions or events or the capability of the Service provider. However, the initial process of developing each of the service delivery options must also be considered.

These risk factors vary depending on the Service Delivery option chosen for each Service.

2.1 Contracted Out

Perhaps the most beneficial aspect of a contracted-out approach is the ability of the private sector to bring their own specialist support services, particularly useful for Health & Safety and IT, which are increasingly crucial elements of public realm services. The potential for wider industry access to the innovative ideas, methodologies and research across the sector enables the re-design of services in light of successful implementation on other contracts.

Contractors are well versed in contract mobilisations and have the skills and capacity to deliver them. Additionally, large organisations with multiple contracts across multiple local authorities have the capability of drawing equipment, staff and experience from other contracts in emergencies and during mobilisation. Similarly, the private sector can provide staff at all levels with specialist knowledge, experience and qualifications specifically relevant to the operational and administrative requirements of the Services.

Against this must be considered the financial risk of the additional costs represented by a contractor's requirement for a profit margin and the addition of central (head office) overheads. The Contract may not be sufficiently flexible to take account of developing legislative requirements, financial constraints or changes to Council policies and priorities; whilst the Contract will incorporate a change mechanism, this may be cumbersome, subject to the contractor's agreement and may not lead to cost-effective solutions. The Council will also need to expend resources on the ongoing management and monitoring of the Contract.

Procurement Constraints

The current marketplace for contracted out services may lead to an ineffective procurement exercise. A combination of an evolving market, the uncertainty created by the Environment Act and the Resource & Waste Strategy, staffing constraints, rising interest rates and inflation and international supply line issues may limit the number of bidders, leading to an inefficient procurement. Current issues include:

- R&W Strategy uncertainty: the government's Resource & Waste Strategy proposals have created a climate of uncertainty regarding the operational requirements which will need to be considered when bidding for Contracts. The uncertainty regarding recycling collections means that the most effective collection methodology cannot be confidently predicted. It is likely that Bidders will need to price up a variety of options with varying resource levels based on their understanding of the likely Strategy outcomes.
- Lack of competition: after a period of expansion, the private sector appears to be retrenching. Companies such as Urbaser who were expanding rapidly through extremely competitive bidding appear to be consolidating current contracts rather than bidding for more. The proposed merger between Veolia and Suez appears to be constraining their bidding activities. The lack of new entrants into the sector continues.
- Vehicles: The provision of vehicles represents a major capital cost for bidders. Private sector preference is for Councils to fund / provide vehicles, with contractors providing maintenance and repair. Lead times for vehicles are lengthening, due to world trading conditions. Due to the R&W Strategy, decisions on vehicles are subject to uncertainty.
- Containers: The statutory duty to collect food waste is likely to create bottlenecks in the supply of dedicated containers (caddies), particularly as many suppliers are in the EU.
- Staffing: The private sector continues to experience difficulties in the recruitment and retention of drivers. The issue is now impacting on loaders and street cleansing staff, due to the expansion of jobs in warehousing and distribution companies.

- Indexation: the issues with staff retention, fuel prices, capital costs and increasing interest rates are leading bidders to propose more complex price indexation, made up of appropriate dedicated indices. The flexibility of this approach is proving more expensive than the previous approach of RPI or CPI indexation.
- Margins: The industry has a history of pricing extremely competitively to maximise market share. However, this led to many contracts being let with tight margins, leading to contractors achieving very low profit margins and often making overall losses on contracts. As a result, bids over the last three years have focussed on achieving acceptable returns, with a combined overhead and profit margin of 10% appearing to be a requirement for bidding teams.

From the Council's perspective, a contracting out procurement exercise will require significant commitment for the Council; the uncertainty regarding the constraints the government may impose will increase the complexity of the process, which may require a longer timescale than previous experience would suggest. Complexities include:

- Structured Specification Preparation: development of a structured tender specification to cover the full range service requirements for the waste and recycling collection service and a structured tender specification to cover the full range service requirements for the street cleansing service. In light of the uncertainty regarding collection methodologies and frequencies in the Resource & Waste Strategy, bidders will need to be required to provide a range of priced options for service delivery methodologies. This may make bid evaluation complex and contradictory.
- Development of Key Performance Indicators (KPIs) and a service credits and defaults regime in the form of a Performance Measurement Framework (PMF)
- Incorporation of service changes or variations envisaged during the Contract term into the tender documentation and specified as optional services in the specification to ensure competitive quotes are obtained and to avoid future changes being considered a material Contract variation should the Resource & Waste Strategy require. Examples may include changes to container provision, frequency of collection or vehicle design.
- Development of pricing schedules to enable bidders to bid back their price for the services on a consistent basis and for the Council to receive a price for undertaking the core services as well as any variable items (e.g. non-core services, day works or in year fluctuations due to demographic growth, as relevant) and to receive an indicative price for any provisional items i.e. service options which may be taken up during the Contract term. This element will be challenging, due to the need to cover all service configurations which the Resource & Waste Strategy may require.
- Tender evaluation may be difficult due to the need to evaluate multiple options and cost matrices to reflect the potential requirements of the R&W Strategy.
- The relatively constrained timescale for the procurement of a new service provider may compromise the mobilisation/transition period. This is likely to be exacerbated by the current uncertainty surrounding vehicle requirements, with the current international supply line issues compromising contractor's timelines for provision of vehicles and containers.

2.2 DSO / LATCo

When insourcing a Service, the Council would be responsible for the costs and staff time involved in building the new service from the ground up; this would include the major capital outlay involved in the procurement of vehicles and plant, the recruitment of suitably experienced operational management, supervisory and support staff and the steep learning curve of operating the new service.

The change of the Council's role from a Contract monitoring to an operational function requires different skill and experience sets. Issues to be considered include:

- Experience – does the Council have sufficient and appropriate operational management knowledge and expertise?
- Mobilisation / Transition – is there experience and capacity within the Council to manage all of the issues involved in transferring the services and staff: TUPE, HR, payroll, accountancy; acquisition of assets; health and safety; etc.
- In the first instance, the outgoing Contractor's staff may choose not to transfer to the LATCo or DSO. This could lead to a critical gap in skills and capacity, and thus recruitment of appropriately qualified and experienced staff to replicate the current management skills would be an urgent matter for consideration.
- Neither the LATCo nor DSO will be able to take advantage of the Contractor's 'corporate' team of specialist staff to deal with issues such as IT, HR, H&S, payroll, finance, industrial relations, maintenance & repair.
- There would also be a requirement for staff to deal with waste-specific issues of procurement (vehicles, containers and equipment), licensing, environmental legislation, strategic development and industry-specific standards.

2.3 Summary

As illustrated, each of the Service Delivery Options represents risks in terms of costs, availability and suitability of resources, significant resource allocation and deployment, and in the case of outsourcing, the potential for an ineffective, time constrained procurement exercise.

A combination of an evolving market, the uncertainty created by the Environment Act and the Resource & Waste Strategy, staffing constraints across the industry (particularly drivers), rising interest rates and inflation and international supply line issues are causing issues for service providers whether private sector, DSO or LATCo.

The option of agreeing an extension to the current Contract with Biffa would only postpone the necessity of dealing with these issues in the medium term.

However, within this timescale, the uncertainty of government funding for waste management (with potential New Burdens Funding for the introduction of food waste collections and Extended Producer Responsibility Funding for recycling collection) will be resolved. This will not only provide visibility of the revised financial costs of waste service provision, but will also provide certainty of service requirements (in terms of number and type of vehicles, materials collected, collection frequencies and staffing numbers). The three-year extension period would thus provide the benefit of postponing the choice of service delivery options sufficiently for the current uncertainties surrounding service provision to be either resolved or more controllable, and government requirements and associated funding confirmed.

This would leave the Council well-placed to make a more informed choice of Service Delivery options in a less uncertain marketplace, and minimise the risks associated with either letting a new Contract or transitioning to a DSO or LATCo approach in a space which makes operational and financial planning, for potential bidders or for the Council, extremely challenging. This would also avoid the procurement costs and/or the commitment of internal resources from teams including Waste, Finance, Legal, Procurement, HR and IT at a time when the solutions to be sought are subject to uncertainty.

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