HEREFORDSHIRE PUBLIC SERVICES SHARED SERVICES PROGRAMME REVIEW OF GOVERNANCE AND PROCUREMENT ISSUES

Introduction

We have been asked to consider the potential governance and procurement issues arising from the proposed Herefordshire shared services programme. This report covers the following topics:

1 Assumptions about priority objectives
2 Shared services partnership options
3 Form of governance arrangements
4 Key inter-partner issues
5 Procurement processes

1 Assumptions about priority objectives

The Business Case and the Outline Procurement Strategy identify a number of drivers for the Herefordshire shared services programme. To determine the way forward, it is important to focus on the priority objectives and assess which structures and procurement options will best achieve those objectives.

In producing this report, we have assumed that the following are the priority objectives for the programme:

(a) **Cost savings** – all three organisations are facing significant budgetary pressures over the next couple of years.

(b) **Quality of services** – the delivery of quality effective back office services

(b) Speedy benefit realisation – cost savings need to be realised quickly, starting no later than financial year commencing March 2011.

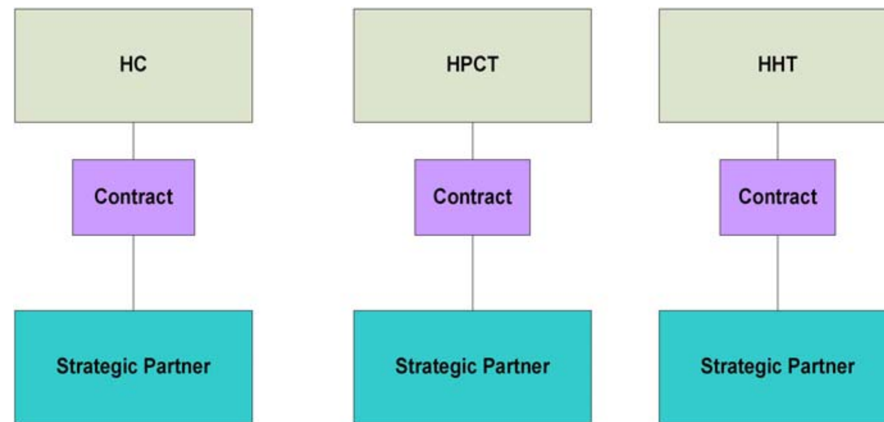
(c) Promotion and regeneration of Herefordshire – adopting the 'Total Place' principles in redesigning the delivery of support services across Herefordshire.

(d) Protecting employment in the County - retaining jobs locally.

2 Shared services partnership options

There are a range of possible options for achieving these objectives, each with its own advantages and disadvantages. These include:

2.1 Joint procurement:
Under this arrangement, the 3 partners could conduct a joint procurement exercise resulting in 3 separate contractual arrangements under a shared framework with a strategic partner. The costs and benefits of each contract would be borne or realised by the partner organisation.



Advantages:

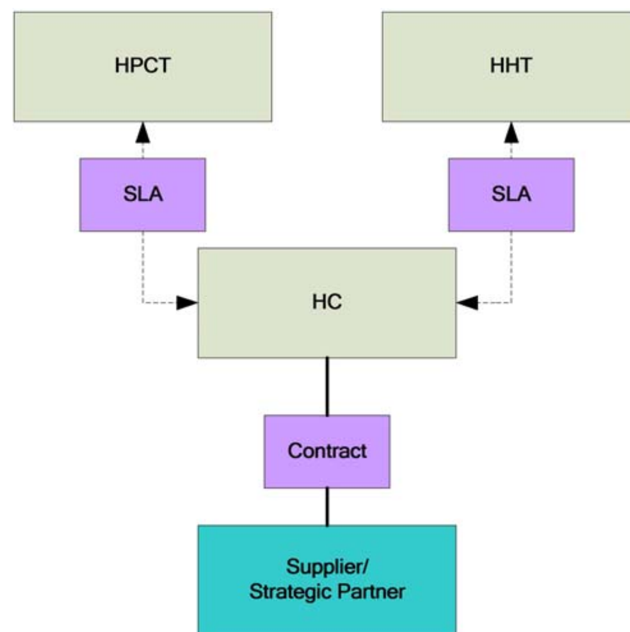
- Each partner free to specify own requirements.
- No need for detailed governance arrangements between the 3 partners.
- Separate financial liabilities.
- If requirements can be identified up front, might be possible to use the restricted procedure (or even the accelerated restricted procedure) as opposed to the competitive dialogue process, reducing the procurement timescales (see paragraph 5 below).

Disadvantages:

- Whilst the 3 entities would have a common supplier/strategic partner, and there may be some integration by that partner, it would not achieve integration in the governance arrangements or service specification. This would not achieve a true shared service arrangement.
- Likely to limit cost savings opportunities, as the strategic partner will view each partner as a separate client. Cost savings will be in the hands of the supplier.
- Procurement issues in transferring additional services to the partnership later on, unless they can be properly specified and evaluated prior to contract signature.

2.2 Lead commissioner/provider:

One of the three partners takes over the relevant support functions and staff, and then provides (or commissions) services on behalf of the other two partner organisations. The arrangements would be formalised into a set of SLAs between the lead partner and the other two partners. By way of illustration the following diagram shows this arrangement with Herefordshire Council as lead commissioner/provider:



Advantages:

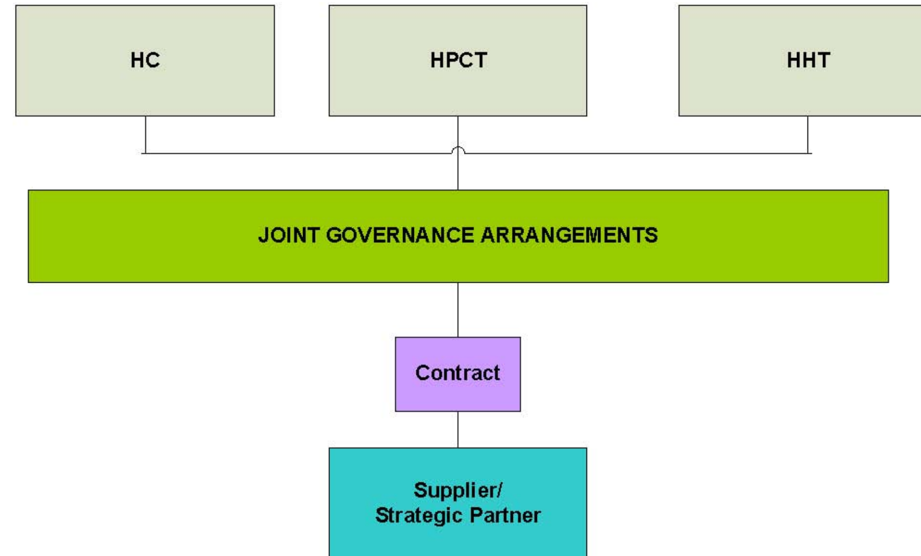
- The costs/benefits would be shared between the partners.
- Provided the SLAs do not constitute contracts for consideration, there should be no need for a formal procurement exercise unless the lead organisation commissions services externally.
- Potential to start off with limited scope allowing early realisation of ‘quick win’ savings. Different arrangements could be introduced for different services over time. Potential to move from provider to commissioner over time, if desired.
- Potential for employment costs savings to be achieved by co-location and integration of staff and bringing them onto a common set of terms and conditions.

Disadvantages:

- Majority of risks will be transferred to the lead partner organisation and/or risk allocation between organisations lacks certainty due to SLA structure.
- If binding contracts between Hereford organisations are considered necessary, this may trigger need to tender these contracts under the public procurement rules.
- Ability to deliver savings (and speed of their realisation) depends on appetite/ability to drive out efficiencies.
- Need to consider possible vires and governance issues.
- No collaboration on integration or forming a new common ethos.

2.3 Transfer the services to a private sector strategic partner:

The 3 partner organisations conduct a joint procurement exercise to appoint a private sector party to run the support services on behalf of the 3 partners. In contrast to 2.1 (where 3 totally separate contracts are awarded with no joint governance arrangements), the relationship with the strategic partner is managed on a joint basis – either through a contract board mechanism (see paragraph 3.1 below) or through a formal joint venture company (see paragraph 3.2 below).



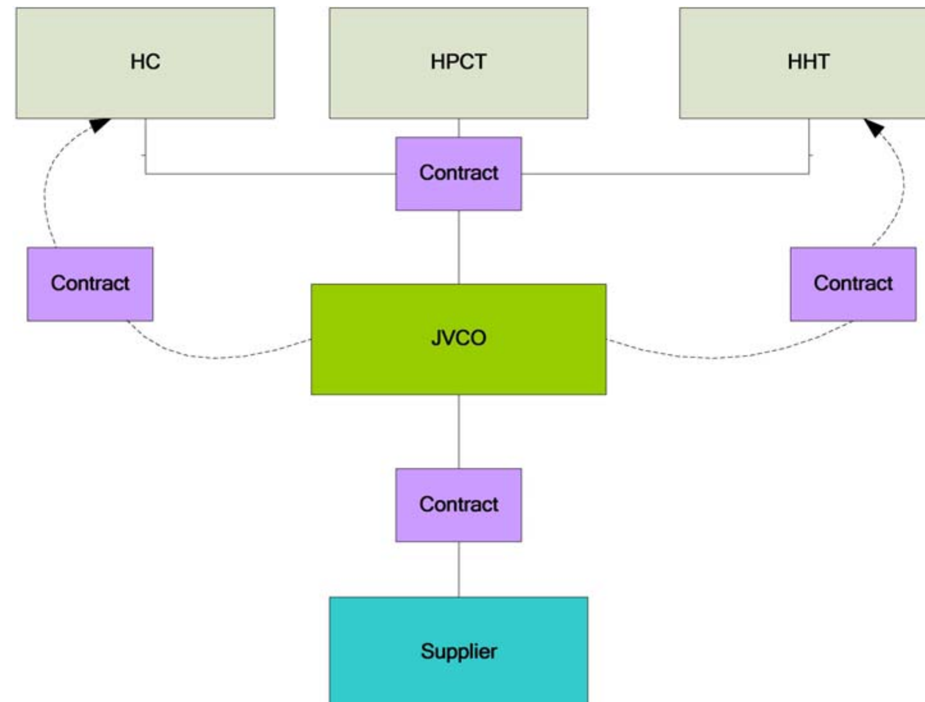
Advantages:

- Able to access skills and expertise which may not be available within the 3 partner organisations.
- Can contractually incentivise strategic partner to deliver efficiencies/transformation/other benefits. Strategic partner can be committed to delivering investment and achieving efficiencies.
- Can procure on behalf of other Hereford organisations who may join later.

Disadvantages:

- Appointment of strategic partner requires full OJEU procurement exercise which will take time and incur significant costs.
- Procurement rules require all services to be tendered and evaluated before contract signed, so this may constrain ability to transfer additional services into partnership later on and limit the extent to which other Herefordshire organisations with different service needs can join at a later date.
- Strategic partner likely to want medium/long-term contract to justify bid/investment costs.
- Even if only a joint contract board, there will need to be joint governance arrangements, and there will need to be an agreement on contribution/liability apportionment between the 3 partners.
- Consideration of vires/SHA sign off required (particularly if separate joint venture company established).

2.4 Establish public/public shared services entity:
The 3 partner organisations set up a shared services entity – a public/public joint venture acting as commissioner/provider – wholly owned (in agreed proportions) and closely controlled (by each of the partners). This JV would have its own separate legal identity, could both provide to and commission services on behalf of the partners, employ staff (on its own terms and conditions subject to TUPE compliance) and buy-in capacity and skills to supplement that transferring into it. For procurement reasons it could not provide services to third parties, save possibly to other public bodies which acceded as joint controlling entities. This could ultimately include an exercise to procure a strategic partner.



Advantages:

- Can be undertaken on a phased approach, perhaps initially with co-location and then with staff/assets (including buildings?)/services being transferred over time.

- No need for procurement exercise to set up JVCo, so savings can be delivered earlier. Opportunity, on transfer, to amend staff T&Cs and achieve immediate savings.

- Ability to ‘pick and choose’ right solution for each service – i.e. some delivered internally; some externalised.

- Can buy in additional capacity to deliver integration.

- Other Herefordshire public bodies can buy in/join in at any time.

Disadvantages:

- Ability to deliver savings (and speed of their realisation) depends on appetite/ability to drive out efficiencies.

- Establishment of JV will require focused engagement between 3 partner organisations and could take time to set up.

- More detailed consideration of vires/SHA sign off required.

3 Form of governance arrangements

Whichever option is selected, the 3 partner organisations will need to establish formal governance processes to regulate, for example, how the partners will share the risks/benefits of the shared services programme. This can be achieved as follows:

3.1 Joint procurement with a contract board:

If the shared services (and all the benefits from the programme) to be delivered by a single strategic partner require only limited formal joint working across the 3 partners (as commissioners or providers), a contract board model would enable the 3 partners to establish joint governance, procurement and contract management arrangements and enter into a single contract with a private sector strategic partner.

If it was agreed that this option was the most appropriate, the arrangements between the partners could be formalised within a formal agreement, but without the need to create a separate company. The agreement would cover all the issues identified in paragraph 4 below, together with issues such as composition of the board; disputes; etc.

3.2 Joint venture company:

3.2.1 Alternatively, to the extent any significant level of service transformation and joint provision is to take place through joint working, the 3 partner organisations could consider entering into a formal joint venture company. This could then act as commissioner alone (in the event a strategic partner is appointed), as provider of services or as commissioner/provider of services if a ‘mixed economy’ approach is selected.

3.3 Issues to consider if establishing a JV company:

(a) Vires/Powers

Each party looking to participate in the JV will need to establish whether it has the legal powers (vires) to do so and obtain any necessary approvals (e.g. SHA signoff). A detailed analysis of the relevant powers is outside the scope of this report, but in principle we believe it would be possible for the Council to establish a joint venture entity, but the involvement of the PCT and HHT would need more detailed consideration and discussion with the SHA. We have experience of negotiating these arrangements, and they are possible, but the HHT powers of participation are more limited than those of the PCT and Council. In general our view is that this is challenging, but possible!

(b) Controls and delegation

All 3 partner organisations would need to be satisfied with the consequences flowing from the fact that the JV will have a separate legal capacity and will be able to make its own decisions, employ staff, enter into contract etc. The primary obligation of the directors of the JV (if it is a company) is to the JV itself. Conflicts of interest would therefore need to be considered. However, the procurement rules (under Teckal and the Court of Appeal ruling on LAML) would require that strategic shareholder control is maintained and appropriate shareholder rights would be included.

Other key issues include: the degree and nature of delegations; governance arrangements; roles and responsibilities of the participating entities; agreement of reserved matters (i.e. where the matter will be decided by the shareholders); how best to monitor the ongoing activities of the JV; the composition and role of the Board of Directors of the JV; appropriate mechanisms to deal with disputes between the participants; deadlock provisions may be needed to deal with situations where it becomes impossible for the JV to continue its business.

(c) Exit arrangements

The partners would need to consider the duration of the JV and what will happen when the JV is no longer needed or if it 'fails'. Exit provisions enable the participants in the JV to realise their investment and protect their interests if other participants wish to exit the JV or fail to meet their respective obligations.

Agreeing the exit provisions is often time consuming and thought should be given to the following questions early on in the discussions:

- Is the JV being set up for a specific task or duration? For example, if its sole function is to act as the governance arrangement for the letting of a contract to a strategic partner, can it continue to exist once that contract has expired/terminated?
- Should the JV agreement cater for both voluntary and compulsory exits?
- Are other entities allowed to join/exit the JV? If so, in what circumstances?
- How are management deadlocks or disputes to be resolved?

(d) Procurement/state aid issues

More detailed advice should be sought to consider the extent to which the procurement rules will apply to the formation of a public/public JV and what governance requirements (particularly shareholder controls) this will impose. Similarly, once the scope/activities of the JV are more clearly defined, advice would need to be sought as to whether there are likely to be any state aid issues which will need to be overcome.

4 <u>Key inter-partner issues</u>

The options set out in paragraph 2 are not mutually exclusive and it is possible to run concurrent procurement (and indeed provider) arrangements, or to phase transition to the full shared services environment using a combination of approaches. However, each of these options require detailed negotiations between the partners in order to establish some principles before embarking on a procurement exercise to find strategic partner or the shared transformation of services.

The key issues to be considered include:

(a) Which of the above structures is most appropriate and will best help the partners achieve their

objectives?

(b) Who meets what costs? How are the service charges allocated between the partners?

(c) Who receives what benefits? To the extent cost savings are realised, how are these allocated between the partners – for example, if achieved via redundancies, does it depend which party originally employed the relevant staff? Or are they split proportionately by value of the services being provided to each partner?

(d) Who carries what risks? For example – procurement risk? Non-performance risk?

(e) Who employs which staff? And on what terms?

(f) Who occupies which or who's accommodation? And on what terms?

(g) How are competing service priorities resolved? Is the intention to have a 'vanilla' service/platform across all three partners? What is the process for agreeing changes?

(h) What happens if it all goes wrong? What is the exit strategy for each service?

(i) In what circumstances will the programme be extended to other public authorities? And on what terms?

The more of these questions which remain unanswered going forwards, the greater the risk of dispute later on. However, conversely, any attempt to resolve all potential disputes before embarking on the procurement or transformation journey, could halt progress. There needs to be a dialogue to establish broad parameters and agreement where possible and understand and manage the risks of later dispute etc.

5 Procurement processes

To the extent the 3 partners (or any JV company established by the 3 partners) decide to procure services from the private sector, these will need to be procured via a formal procurement procedure (assuming the contract value is over the relevant threshold). A decision would need to be taken as to which process to use, as this can have a significant impact on the cost and duration of the procurement exercise.

Competitive dialogue: – this is intended for use on complex projects where it is not possible to define the technical/legal/financial solution in advance. A dialogue phase allows parties to discuss and refine the approach, before calling for final tenders on the basis of agreed contract terms. The typical duration for a competitive dialogue procurement is 915 months (sometimes longer).

Restricted procedure: this can be used where the partners can clearly set out their requirements in advance, where the bidders are presented with a draft contract and are asked to submit a priced proposal. No negotiation of the contract is allowed once it has been issued to bidders, only clarification. The typical duration for a restricted procedure procurement is 69 months.

Accelerated restricted procedure: this reduces the basic minimum procurement timelines from 3 months to a minimum of 1 month and enables tenders to be conducted, typically in 2 to 4 months. It has been approved by the EU Commission for 'major public projects' procured during 2010 on the basis that speeding up the procurement process would provide a boost to the economy in the current financial climate. The application of the accelerated restricted procedure to a procurement has to be considered on a case by case basis.

Conclusion

Whichever route is followed the key to success is that there is a shared understanding and common purpose amongst the partner organisations. The governance arrangements can fit the purpose. Clearly incremental change is the least challenging to the culture and timetable, but may not deliver the required step change in performance or cost-saving. A balance will need to be struck.

In our view, the next step is to get engagement with the partners at an appropriate level, which must include financial as well as operational considerations; assess risk appetite and agree prioritisation of the objectives. From there it is possible to work up a detailed proposal which will deliver against those shared objectives within the timeframe.

The proposition is innovative, and very much at the cutting edge of local governance and local solutions to service delivery.

22nd January 2010