APPENDIX 3: Integrated Waste Handling Service Delivery Options - Evaluation and Background

Report title: Integrated Waste Handling Service Delivery Options
Report to: Cabinet
Report author: Councillor Simon Walsh, Cabinet Member for Environment and Climate Change Action
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County Divisions affected: All Essex

1 Overview

1.1 The report highlights the uncertainty that Essex faces in several areas including national and local Waste Strategy, future market volatility, the outcome of the Environment Bill and residual waste disposal.

1.2 The above challenges will inevitably require the service to adapt swiftly to changing market conditions and new strategic targets, so it is critical the delivery model can deliver new initiatives in a sustainable and cost-effective manner.

1.3 The options evaluated in this report focus on either an in-house model where ECC directly employ all staff to deliver the service or establish a LATC to provide the service and transfer all staff into the new entity.

1.4 The In-house model would deliver maximum agility and control over service aspirations to meet the above future pressures without the additional layers of governance or implementation risk that an LATC would create.

2 Market Analysis

2.1 Recent Market Engagement highlighted that only three bidders were interested in talking to ECC about providing the IWHC service. Providers appear to be focussing on fully integrated waste disposal contracts, which include the operation of RCHWs and WTS's, so there are now only a limited number of companies that would be likely to bid for the IWHC service in its current form.

2.2 Recycle value and material marketing risks are a major concern for bidders. The Resources and Waste Strategy, exit from the European Union and Covid-19 are likely to cause long term market volatility and contractors will price these risks for any future procurements.

2.3 The introduction of the national living wage has reduced the ability for contractors to be as flexible as possible with staff pay, which further reduces competition, as this is the largest cost element for the service.

2.4 As a result of the changing market and risk profiles, procuring a flexible value for money service may not be achievable in the short to medium term. It is therefore important that any decision focusses on the possible benefits for the recommended in-house delivery vehicle.

3 Summary of LATC Delivery Vehicles

3.1 The below summary is a more detailed breakdown of setting up the LATC delivery vehicles, which are referenced in sections 3 and 4 of the main report.

Teckal Status

3.2 ECC will need to ensure that it remains compliant with Regulation 12 (Teckal exemption) throughout the life of the LATC, including ensuring that the following conditions are satisfied:

a) ECC exercises control over the LATC similar to that it exercises over its own departments;
b) More than 80% of the activities or turnover if the Ltd are carried out in the performance of tasks entrusted to it by ECC; and
c) There is no direct private capital participation in the Ltd.

3.3 In the event that the LATC wanted to outwardly trade, it is unlikely that the above conditions would be satisfied and therefore it would be classed as a non-Teckal company. This status means that it would not be subject to public sector procurement rules, so the LATC would need to tender for any work with ECC and be subject to the same evaluation criteria as any other supplier.

VAT

3.4 Under VAT statute that applies to ECC, waste disposal is deemed non-business and therefore VAT isn't charged on the provision of the service. However, any input VAT incurred can be reclaimed under section 33 of the VAT Act that allows ECC to reclaim input VAT on non-business activities.

3.5 Although ECC can apply the non-business provisions of the Act, the provision of the service by a separate delivery vehicle would be standard rated. This means VAT would need to be charged on service invoices issued by the LATC, whether those services are to the public or ECC. The LATC would be able to reclaim any input VAT incurred and ECC can reclaim any input VAT charged by the LATC under s33 as above. A LATC would need to register for VAT and operate the accounting records and VAT administration processes separately from ECC.

Limited Company (Ltd)

3.6 ECC could establish a Ltd company to operate the service and would be a 100% shareholder in the company.

3.7 Once the Ltd becomes incorporated, ECC would need to appoint directors to the company. It will also need to consider the most appropriate governance structure by drawing on the experience gained on its other wholly-owned companies or delivery vehicles.

3.8 The Ltd may be subject to Corporation Tax on any profits that it would make. The Ltd company may satisfy HMRC's requirement for 'mutual trade' status, meaning there would be no corporation tax on surpluses where the company is trading solely with ECC.

Limited Liability Partnership (LLP)

3.9 ECC could establish an LLP to operate the service and the partnership must have at least 2 members and 2 designated members (which can be the same corporate body). ECC would be a member and designated member, with a 99% interest in any LLP, with another entity being a designated member with a 1% interest. The Member acts as the LLP's agent and is only liable to the amount they have contributed to the LLP, unless the member agrees to contribute to the LLP's assets on its winding up. A designated member is a statutory role and has responsibilities and functions that are similar to those that a Ltd company director/secretary is required to do under company law.

3.10 The governance structure for the LLP would consist of a board membership to provide political, legal and financial oversight and accountability.

3.11 An LLP is not taxable in its own right on the profits that it generates, unlike a company, instead, the profits of each LLP are allocated to the individual members (partners) who are responsible for reporting their share of profits to HMRC in their individual tax returns, and for calculating their tax liabilities.

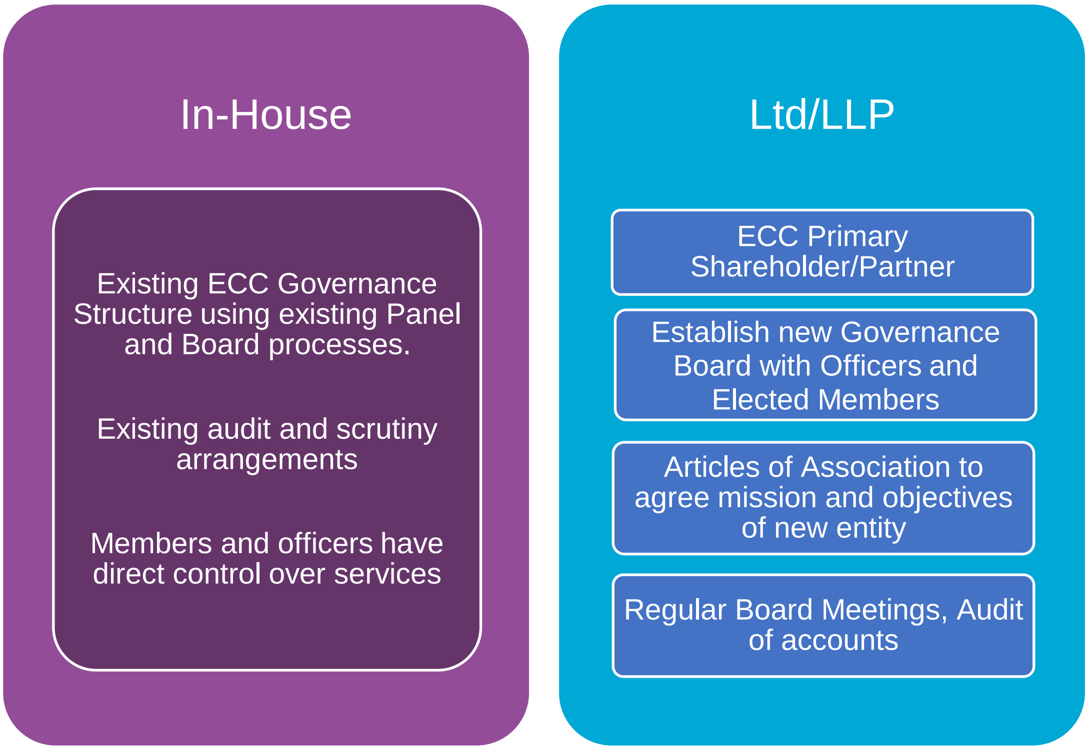
3.12 Given that ECC would be appointed as a full legal member of the LLP, any surpluses or gains attributed to ECC would be exempt from Corporation Tax, because of the ECC's absolute exemption. The minority partner may be liable to Corporation Tax depending on their status.

Evaluation of LATC delivery Vehicles

3.13 The benefits and risks of establishing the Ltd and LLP options are broadly similar, so for the purposes of this report they have been evaluated together. Each option has slightly different requirements in respect of ownership, but governance and VAT implications would be similar. The Ltd would need to qualify for mutual trade status to ensure that any profits are not subject to Corporation Tax, whereas this would not apply to ECC under the LLP option.

4 Governance

4.1 The In-house model would use existing governance with ECC to make changes to respond to future pressures and opportunities. The same principles exist with a LATC, but any proposals would also need to be approved by the Board of Directors. This could result in potential conflict between the commercial viability for the company and ECC's aspirations, which would ultimately impact on deliverability. A summary of the governance for each option is shown in the table below:



5 Evaluation:

5.1 To arrive at the recommended approach, officers from Finance, Organisation Development and People (ODP), Procurement, Service Operations, Technical and Service Strategy teams evaluated the viable options using qualitative and quantitative techniques.

5.1 **Qualitative Assessment:** Officers carried out a qualitative assessment of the 2 options: Option A: In-house and Option B: LATC.

5.2 The options were scored based on feedback from all departments using the following criteria:

- Future financial savings
- Customer service
- Control / Governance
- Continuous improvement
- Deliverability
- Risk management
- Market

5.3 Following scoring of the options against a set list of criteria by individual officers, scoring was undertaken collectively to arrive at a single set of scores and supporting rationale evidence. A summary of the results of the consensus options scoring are set out in Table 2.

Table 2: Collective Scoring Summary

Model	Score (out of 70)
Option A: In House	52
Option B: Local Authority Trading Company	48

5.4 A summary of the results taken from the qualitative assessment is outlined below in Table 3. This concluded that Option A: In-house delivery model was the most advantageous from a quality perspective: scoring higher than Option B in terms of control/governance, customer service and continuous improvement. It also scored well in respect of deliverability and risk management. However, Option A scored slightly lower on future financial savings and market due to the additional costs of allowing staff access to the LGPS. In order to mitigate against these and other risks identified during the development of the options, a risk register has been established and a copy can be found in Table 4 of this document.

Table 3: Quality Scoring Summary

	Option A (In-house)	
Future financial efficiency	7	Longer term efficiencies over the 7-year model, as most set up costs will be a one-cost. LGPS access for staff increases future cost, but this option would eliminate further procurement costs and greater control provides opportunities to deliver savings from increased waste diversion and improve overall efficiency.
Customer service	7	Opportunity to improve customer service through direct employment of staff and ensuring that they embrace ECCs organisational behaviours
Control / Governance	9	Control over staff provides significant ability to change services and delivery methods to ensure that ECC can adapt to market and residual waste disposal uncertainty. Decision making and implementation of proposals would be quicker with no additional layers of governance, so Members and officers can steer direction of the service.
Continuous improvement	8	Improvements will need to link to ECC's growth agenda and capital investment plans. Without private contractor or governance barriers any invest to save initiatives would be easier to implement, particularly focusing on establishment of waste diversion initiatives, reuse activities and improved social value.
Deliverability	8	All existing staff would transfer into ECC under TUPE arrangements, which provides continuity of service. Future recruitment would need to focus on bringing in staff with direct operational delivery experience and support from ODP, Legal, Health and Safety and Finance has already been modelled for under this option.
Risk management	6	Market risk is the same for both options, but private contractors have already stated that they would not be prepared to take these risks and would pass these back to the authority. Other risks surrounding Health and Safety (H&S) and People would be additional factors to consider, but with adequate ODP Support and good H&S policies and procedures these risks can be mitigated.
Market	7	LGPS access for staff would be a risk for future re-procurement but going back out to the market would attract contractor profit margins and there is already reduced market competition, as well as volatile market conditions. ECC's short to medium term legislative and disposal uncertainty mean that short to medium term procurement is unlikely. There is potential that the service could form part of a longer term integrated disposal contract, but this would be at least 5 years away depending on the outcome of Tovi and any pension liabilities would be more diluted into a bigger contract costs and spread over a longer term contract.
Overall Score	**52**	

	Option B (Local Authority Trading Company)	
Evaluation Criteria	**Score**	**Rationale**
Future financial efficiency	8	Ongoing support costs reduce the level of efficiencies that can be delivered from the operational model, but savings in the costs of pension contributions offset this. Extra layer of governance would make implementing savings initiatives more difficult and the company would need to remain commercially viable. Borrowing costs would be higher than ECC rates to ensure that the company is operating within the parameters of providing subsidies to corporate entities (previously known as state aid)
Customer service	7	Values and behaviours for staff would need to be established to ensure customer service levels are improved and a key objective for the LATC would need to be customer satisfaction.
Control / Governance	7	Governance for LATC would create an extra barrier to making changes to the service and control over staff or recycling performance. Objectives for a LATC would need to ensure full flexibility for service changes and the Board Members would need to ensure any changes do not adversely affect the company's financial performance.
Continuous improvement	7	Improvement should be built into the company's business plan, but this may present difficulties where the commercial aspirations of the company and ECC need for changes do not align. Any improvement initiatives would need to be submitted by ECC to the Board for approval, which again creates an additional layer for decision making. Conversely any LATC driven changes would need Cabinet approval.
Deliverability	6	The set-up of the LATC would need to ensure full integration with ECC's governance and support systems. This would take time to establish and presents a significant risk to overall project deliverability. For example, Essex Housing has taken over two years to get to its current position.
Risk management	5	A significant risk for the LATC would be deliverability in the required timescales. The lack of key drivers does create uncertainty as to whether the cost and time for setting up a new company will generate justifiable benefits. Other risks surrounding TUPE are same as the inhouse model. However, Directors of the company would take on private liability for corporate responsibilities that would need to be insured. The LATC would also be more prone to changes in business and taxation rules.
Market	8	The LATC would mean lower costs if ECC decided to put the service back out to the market in the future, due to lower staff pension contribution costs, but contractor profit margins and the same market uncertainties still make any procurement in the short to medium term unlikely.
Overall Score	**48**	

5.5 The main weaknesses of Option B are the costs and risks surrounding setting up a new company. There is also insufficient time to ensure that the company is established to provide the service from April 2022. The additional layer of governance that would be introduced to implement any proposals are also a key consideration as the company would need to ensure that any changes were commercially viable.

5.6 The LATC has limited commercial drivers as it would struggle to compete outside ECC due to the profit margins that would need to be applied. This would make costs equivalent to other companies in the sector and other local authorities would be unlikely to choose an unexperienced company over more established providers. The only remaining driver is the saving that would be achieved from reduced pension contributions, if the service was re-procured in the future, but officers do not envisage the market changing in the short to medium term.

5.7 One of the most apparent risks of both options relates to the potential transfer of staff from the current Contractor to ECC under the Transfer of Undertakings (Protection of Employment) Regulations (TUPE) and the associated costs. Such staff transfers may lead to increases in employer liability costs. While the existing contract does require the Contractor to provide ECC with specified employee information to ECC when requested, the final employee liability information may not be received until 28 days prior to transfer (the timeframe specified by TUPE).

5.8 Option A brings several important potential upsides including an improved image for the frontline service with all staff being fully embedded into ECC. Direct employment enables ECC to offer access to the LGPS and Essex Reward Gateway to motivate staff to focus on customer services, waste diversion and delivering innovation. Service changes could be implemented quickly without barriers and increased flexibility would allow ECC to work more holistically with other departments and partners to explore potential savings to the taxpayer.

5.9 Option A achieved the highest overall quality score of 52 out of a potential 70 quality points.

5.10 **Quantitative Evaluation**

5.10.1 The quantitative assessment provides an evaluation to assist the operational and value for money decision.

5.10.2 It considers an in-house run service using public capital against the use of a LATC, which would require borrowing at market interest rates to ensure the company is operating within the parameters of providing subsidies to corporate entities (previously known as state aid).

5.10.3 The model to review the delivery options has been designed to meet the following approaches:

- to ensure that the simplicity of approach reflects the early point at which this analysis takes place;
- to focus ECC's attention on the underlying assumptions and the interplay with qualitative judgement;
- to mitigate future costs and ensure that ownership of the decision lies with ECC;
- follows the principles in the Green Book to introduce consistency across the public sector and improve the underlying evidence base.

5.10.4 A summary of the quantitative evaluation and the results can be found in the Confidential Appendix: Table 1.

6 Risk Mitigation

Both options carry several risks for ECC. Table 4 outlines the key risks identified and the proposals to reduce the risks to acceptable levels.

Table 4: Risk Profile

Option	Risk	Probability	Mitigation
A	Increased cost in respect of natural turnover of staff transferring into ECC, where Essex Terms and Conditions would apply to any new recruits.	**High**	Worst case scenario costs have been included in the financial model for the in-house model.
A & B	If the Authority decided to put the service back out to market in the future any changes to employment terms resulting in elevated pension costs, salary or other staff-related costs could increase the cost of the service.	**High**	Accept. Market analysis shows that competition in the market has reduced and due to a change in focus for suppliers, re-procurement in the short and medium term is unlikely.
A & B	Local Government Reform leads to changes in the Essex Waste Disposal Authority organisation in	**High**	All future options are vulnerable to this risk. Option A facilitates full control over the service and labour force, which creates

Option	Risk	Probability	Mitigation
	terms of geographical scope and/or powers.		more opportunities in terms of integration.
B	Timescales to establish a new LATC represent a significant risk for the service implementation in April 2022	**High**	Accept. Additional resource would be required to mitigate this risk. However, this is difficult to quantify and even with this in place, there is no guarantee that the company would be ready.
A	Without sufficient internal resources the In-house Model would struggle to be delivered.	**Medium**	Resources for the management of this project have been identified alongside the wider waste transformation programme
A & B	RCHW service is highly visible and therefore any employee relations matters which arise could cause reputational damage	**Medium**	Use ODP expertise to ensure early engagement with staff and dialogue to understand issues. Financial modelling for both options includes Human Resources to support the business directly. Further employee matters and considerations are highlighted in paragraph 7 below
A & B	Pending changes in national legislation for example; to issues such as extending to issues such as extended waste producer responsibility	**Medium**	Flexibility built into In-house model (Option A) to allows efficient solutions to support changes, whereas governance barriers would exist for the LATC

Option	Risk	Probability	Mitigation
A & B	Covid 19 and Brexit may impact International Supplies requiring longer lead in times for mobilisation.	**Medium /High**	This may impact on the procurements required for Option A. The project team are closely monitoring lead times and will explore leasing or bring procurement forward if the situation requires.

7 Employment and People Implications

7.1 For both options there are a number of significant employment and people implications to ensure compliance with the Transfer of Undertakings (Protection of Employment) Regulations 2006 Regulations, and to ensure risks and opportunities are effectively managed.

7.2 ECC would need to inform the appropriate representatives of the affected employees of the transfer of any measures proposed and would need to consult on any proposed measures. Certain specified information would need to be provided to the representatives long enough before the transfer to enable the outgoing employer to consult with them about it.

7.3 If there are any changes or proposals for changes following the transfer, these "measures" would have to be discussed with the representatives of the affected employees. The incoming employer is required to provide the outgoing employer with information on proposed measures to allow the outgoing employer to comply with its duty to inform and consult. There is no set timetable for consultation, but it must be in "good time" before the transfer, and the larger the transaction and the more staff affected, the longer the timetable will need to be.

7.4 TUPE provides that all the transferor's rights, powers, duties and liabilities under or in connection with the transferring employees' contracts of employment are transferred to the transferee. This grants rights under the contract of employment, statutory rights and continuity of employment and includes employees' rights to bring a claim against their employer for unfair dismissal, redundancy or discrimination, unpaid wages, bonuses or holidays and personal injury claims. Any dismissals will be automatically unfair, where the sole or principal reason for the dismissal is the transfer. Dismissals may not be automatically unfair where the dismissal is for an ETO reason requiring a change in the workforce. This ETO defence is narrow in scope and must entail changes in the workforce, e.g. job functions, workforce numbers.

7.5 Conceptual designs have been completed in terms of what (if any) additional roles would be required to support the recommendation. Although any final recommendations would need greater detail in terms of any current team structures, this detail may not be available until the due diligence stage (far closer to the actual TUPE date). This could present a risk around the amount of time to validate and progress any new posts before individuals would formally TUPE in. Financial modelling has included two full time employees for ODP to support the implementation of the TUPE and service integration.

7.6 The natural turnover of staff following insourcing may result in inconsistent terms and conditions within the service, that could result in possible equity claims and impact on how attractive this service would be to market, should there be a desire to spin out into a contractual model in future. The insourcing of this workforce could make any future procurement more expensive, as the workforce would be offered access to the LGPS and any new staff would be employed on Essex Pay.

7.7 Information and consultation failures can result in joint and several liability between the outgoing and incoming employers, although the contract governing the transfer can cater for apportionment of liability here. A failure to comply with TUPE could expose ECC to potentially large claims.

7.8 Whilst the staff costs associated with the both options have been modelled, as we are not yet in due diligence, we cannot be clear on the current or future liabilities, which remains a risk. This includes costs associated with contractual terms which are both written and implied. There could also be an additional cost to integrate this workforce and their terms onto our current systems, previous changes have come with considerable cost and have had long lead in times, however this detail cannot be provided until further information is available.