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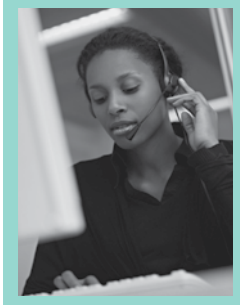
Branch guide to local authority trading companies



UNISON
Local Government

Introduction

More and more councils are considering setting up arms-length local authority trading companies (LATCs). These operate as separate entities to the council but are wholly owned by them. LATCs do not include companies where councils only own a stake and the rest is owned by a private company. Such joint ventures need to be treated as another variant on out and out privatisation.

The motivations for setting up a LATC vary. There are two broad types of company that councils may seek to set up: the service delivery model where the company's main activity is to do work for the council itself (or a group of councils) and the commercial trading company which intends to trade more widely with external organisations and/or individuals. Where the council's objective is wider commercial trading, it cannot simply award work to the company. It must put the work out to competitive tender - with the risk that somebody else may win the contract, leaving the LATC dead in the water.

However councils do have other alternatives if they wish to sell services more commercially.

This guide gives branches background information and advice about how to deal with proposals to form trading companies.

This guide looks at:

1. Local authority trading companies – the facts
2. Procurement rules – the 'Teckal' tests
3. How branches can challenge proposals
4. Case studies
5. Sources of further information

1. Local authority trading companies – the facts

Local authority trading companies (LATC) are also sometimes known – especially in Scotland – as arms length external organisations (ALEO). An early decision the council should make is whether it wishes to use the company for commercial trading, or as a vehicle primarily for delivering the council's own services.

Commercial trading companies

In England and Wales, councils have powers under the 2003 Local Government Act[1] to set up companies to trade with a view to making profit in areas relating to any of their existing functions.

In England, the General Power of Competence[2] also now allows councils to do anything an individual or company may do, as long as it is not expressly prohibited by other legislation. This means that councils in England can potentially charge or trade in a much wider number of service areas than traditional council functions – for example selling insurance or phone and broadband services. It also means they can trade anywhere in the UK or beyond! However they cannot trade with individuals where they already have a statutory duty to provide those individuals with that service.

If trading is to be done in the wider commercial market with a view to generating a profit (rather than just on a broad cost recovery basis), in England and Wales the council must establish a company. This can be a company limited by shares, a company limited by guarantee or an industrial and provident society – see UNISON guide to service delivery vehicles: www.unison.org.uk/acrobat/B5380.pdf

1 Section 95

2 2011 Localism Act

In Scotland the 2003 legislation gave a wide power to councils to trade for profit, with no requirement to establish a separate company. Councils have to exercise the power under the heading of advancing well-being.[3]

In Northern Ireland powers are narrower and relate back to the original 1970 Local Authorities (Goods and Services) Act. Northern Ireland councils must therefore identify a power available to them before undertaking trading activity.

Service delivery companies

- A council may set up a service delivery company which is solely concerned with delivering a service back to that council but does not trade significantly with external organisations. This is likely to qualify for the 'Teckal' exemption from procurement rules which means that the council can pass work to the company without having to put it out to competitive tender – (see section below: Procurement rules: theTeckal tests)
- Where councils want to sell goods or services to other councils or public bodies, they will only be dealing with each other and not seeking to operate in a wider market. These are often referred to as 'shared services' or public-public partnerships. The partners can set up a 'Teckal' company but they do not have to. If they do not set up a company they do not have to put the work out to competitive tender, are still able to generate a profit and are not restricted to cost recovery – as long as they only trade with each other. They also avoid all the

3 Local Government in Scotland Act 2003 and the Local Authorities (Goods and Services) Act 1970.

downsides of a company such as VAT and corporation tax (see below).

(For more on shared services arrangements see Branch guide to: Shared services).

Processes for establishing a company

Councils should have carried out a service review and a full options appraisal. There is a tendency for councils to jump into trading activity without being clear about what they are trying to achieve, what the pitfalls might be and whether there are less risky alternatives for achieving the same goals.

Before embarking on a trading operation, a council must satisfy itself that it has considered all the risks of such an undertaking. This includes developing a full business case which covers projected financial performance and risks. Any decision to proceed with a trading company should be accompanied by a full business plan covering how the company will operate.

The council must decide the company governance structure including the composition of the board and how the council will be represented – usually through a mixture of councillors and officers.

In our experience, councils often pay consultants to advise on business cases and business plans. There have been many instances where consultants' projections of future revenue and trading opportunities have proved wildly optimistic.

Trading companies can and do get into financial difficulties. Therefore councils should ensure that there is an exit strategy written into the company's constitution, covering what will happen if the company becomes insolvent.

Most company structures will involve limiting the liability of the company directors. Councils may be under no obligation to meet the company's debts and liabilities should it get into trouble, but political and service delivery considerations may mean they choose to.

Tax liabilities

Most trading companies will have to pay corporation tax whereas in-house trading or joint arrangements with other public bodies do not. (There are a couple of exceptions for charitable bodies and limited liability partnerships.)

In addition they will be liable in their own right for VAT, will have to pay national non-domestic rates and will be liable for any stamp duty and land tax.

All these tax effects add to the cost base of a company compared to in-house service delivery.

2. Procurement rules: the Teckal tests

The EU procurement regulations usually require councils to undertake a prescribed competitive tendering process, including advertising in the Official Journal of the European Union (OJEU) before they can award work to a company (see UNISON's guide to procurement). This poses a problem for councils as there is no guarantee that the trading company would win the tender.

However where the company is wholly owned by the council there is an exception to procurement rules known as the 'Teckal' exemption (named after a particular legal case). The tests for whether a local authority owned company qualifies for the Teckal exemption are:

- The council(s) must control the company and its activities in the same way as they do they own departments and activities (control test)
- The company must predominantly undertake work for its controlling council(s) – any activity undertaken for external bodies is minimal (function test)

The constitution of a 'Teckal' company must ensure that the council(s) has decisive influence and control over all decision-making.

A Teckal company will not be able to focus on trading commercially in the wider market. Where councils are seeking to do this, they will have to put any work out to tender and the trading company will have to compete for it against any other bidders who decide to tender. The implications of this limited Teckal exemption are not always well understood by councils – we have seen business cases that have failed to appreciate the impact of tendering rules on their plans.

Councils should be aware that the 'function' test above is likely to be tightened up. The European Commission is currently considering a draft procurement directive due to be implemented by 2014 which will quantify how much external work can be undertaken. A limit of 10 or 20% of turnover from external trading activity is likely to be applied.

Branches should look carefully at any business plans and ask the council what account it has taken of the 2014 Directive in terms of projected turnover and external trading plans.

Teckal companies and co-ops/ mutuals

Many councils with strong prompting from government (and in some cases grant money) are trying to encourage their staff to 'spin-out' from council employment and set up co-ops or mutuals to run services under contract from the council. One of the barriers they face in convincing staff this is a good idea is the fact that contracts cannot simply be handed over from the council to a co-op or mutual – they need to be put out to competitive tender with no guarantee that a co-op or mutual that is newly established with no assets or track record would win (see Branch guide to: co-ops and mutuals).

This has led councils to try to find ways of using the Teckal exemption to further their aims in this area.

Case study – North West council

The UNISON branch was approached by the council with a plan to set up a trading company which the council said would take over a number of service areas in adult social care. It would also trade commercially with members of the public in the form of personal budget holders, both within its own council area and in neighbouring areas. The council stated that it wanted a 'hybrid' company – partly owned by the council and partly by employees in the form of an employee share scheme. They also said that the work could be moved over to the new company without a competitive tender process.

UNISON was able to successfully challenge the council on this matter. There were two reasons why the council could not rely on the Teckal exemption: the fact that part of the company would be owned by employees and not by the council and potentially the intention to trade with the public which could have amounted to more than minimal trading outside the council. After UNISON's intervention the council had to reconsider.

We are now seeing councils trying to establish Teckal companies to pave the way for a co-op or mutual further down the line. This way they think they can get the staff used to operating as a commercial entity while in council ownership ready for 'spinning out' into employee ownership further down the line.

"Fitting a mutual company into the Teckal exemption can be difficult because voting and control rights must remain with the public sector owners, rather than the employees of the company."[4]

If a council operates a Teckal company for a period of time and then decides it should become an employee owned mutual or co-op it will need to sell the company to the employees and at this point any contracts it has with the Teckal company will need to be re-tendered, as the Teckal exemption would no longer apply once the ownership and control change. Once again there is no guarantee that the newly formed co-op or mutual would succeed in winning the contract.

4 Local Government Lawyer, The use of Teckal company structures in public service delivery, 16 January 2013

3. How branches can challenge proposals

A local authority trading company may at first glance appear preferable to an outsourcing exercise. In some cases it can be – especially if it is a Teckal company so staff don't face the risk of losing out in a competitive tender, and the company doesn't seek to cut terms and conditions. But in others it can end up being a stepping stone to privatisation, or a cynical attempt by a council to implement an arm's length cost-cutting exercise.

It is vitally important for UNISON branches to get involved early when there is any suggestion that their council might be looking to set up a trading company and insist on full and meaningful consultation throughout the process.

There are 8 key areas branches should focus on when a trading company is proposed:

3.1. What's their game – establishing the motives

3.2. Procurement issues

3.3. Equality implications

3.4. Accountability and conflicts of interest

3.5. Does the business plan stack up?

3.6. What if it goes wrong?

3.7. Alternatives which work

3.8. Negotiating issues if a trading company goes ahead.

3.1. What's their game? Establishing the council's motives

It is important at the outset for branches to establish the real reasons why the council is going down this road. There are usually three broad drivers for councils wanting to set up LATCs:

- Because they are trying to save money on the services by allowing the company to employ staff on worse pay and conditions than the council's. In some cases they may also be seeking to avoid equal pay liabilities. We have seen this regularly in social care
- Because they want to sell services to other organisations and/or individuals in order to generate income for the company which can be ploughed back into the council to reduce the costs
- Because they want to 'stimulate' the market by reorganising a package of services on a more commercial footing in the hope of encouraging companies to move into these areas when the work is put out to tender at a later date

So it is important that branches ask their councils:

- Why do you want to set up a trading company?
- What are you trying to achieve in the short, medium and long term?
- What alternatives have you considered?
- Have you considered using shared services/public-public arrangements which don't require a company in order to trade with other public sector organisations?

- Have you considered how you can maximise use of powers to charge?

Also ask to see any documents the council has prepared – such as the feasibility study and the options appraisal. The options appraisal should detail a number of different options that have been considered for the service and give some idea why the trading company has been chosen over the others.

It is important that branches seek to influence the options appraisal, including ensuring that there is consideration of an in-house option. The in-house option should not just be the status quo – there should be a proper consultation and review of how an in-house service could be improved and expanded – possibly through the use of charging powers and trading arrangements with other councils and public authorities.

Adult social care and personal budgets

We have seen many examples of councils saying they need to set up a trading company because social care service users are moving to personal budgets and direct payments cannot be spent on council services. This argument is a red herring. A personal budget is an allocation of the value of care and support someone is entitled to. If they wish to receive a package of council provided services there is no need to give them a direct payment. If someone chooses a direct payment it should only be because they specifically do not wish to use council services but want to employ their own care worker or use an agency. Furthermore there are examples of councils which are providing services for people with direct payments to buy – for example cleaning or gardening – making use of their charging powers to do so.

3.2. Procurement issues

a. Competitive tendering

As discussed above, an early question for a UNISON branch is whether the council intends to set up a company which complies with the three tests which would qualify it for the 'Teckal' exemption. Teckal companies are probably the least risky for staff, however once the company is established, the company may decide to 'spread its wings'. This would mean that the Teckal exemption would no longer be available at the end of a contract period.

If your council intends to set up a commercial trading operation, it will have to comply with the procurement regulations and put work out to tender. There can be no guarantee that the proposed trading company would win the work. Instead members may find themselves transferred to a private contractor.

Key questions to ask:

- What length of contract does the council intend to give the trading company for the work that it awards? A longer contract will give staff a longer period during which the company can seek to establish itself – a contract of only a few years makes the company very vulnerable.
- What assessment has the council made of the company's ability to compete successfully against other contractors?
- Does the trading company's business plan focus on winning work from other public sector organisations rather than

trading in the wider market? If so then a shared services approach through a joint committee or partnership agreement could be a better way forward

- Will the trading company be seeking to sell services to private companies and the voluntary sector? Which prospective customers has it talked to and what commitments have been given? Significant trading in this sector will mean that the council's own work can't be awarded to the company without a tender process
- Will the trading company be seeking to sell services to members of the public? What market research has been undertaken by the council to determine likely levels of demand?
- Has the council considered the alternative of using its powers to charge for services – this would have several advantages over setting up a company. These would include savings on set-up and administrative costs and exemption from tax and VAT. Furthermore, councils can borrow much more cheaply than a company, which will have to borrow at commercial rates. A council-owned company seeking to make profits from trading with the public could put the council at risk of reputational damage.

b. State aid

Branches should pay close attention to what support and set-up help the council proposes to give a trading company where it is intended to operate as a commercial company. Any support provided by the council to a trading company counts as assistance – whether in cash or in kind. Significant subsidies in grants, assets, services or kind could be deemed State aid which is regulated under European competition rules to stop contractors gaining an unfair advantage over others. If the total adds up to more than €200,000 the council may need to seek permission to proceed from the European Commission.

To avoid State aid issues, the trading company should pay commercial rates for all staff time, premises, payroll, finance, HR, assets, access to IT systems and other support that it gets from the local authority. The council should avoid treating a trading company more favourably than it would treat any other third party contractor.

We have found that councils often do not consider all the different forms of support – tangible and intangible – that they may be providing to their trading company. Failing to do so means they leave themselves open to challenge. Branches should try to ask questions which show elected members that the plans have not been well thought through and that there are risks not accounted for. This may help you chip away at the business case for a trading company and ensure that other, less risky alternatives are explored.

So here are some key questions for branches to ask:

- What assessment has the council made of the total value of the support it will give the company including advice, staff support, intellectual property, assets, use of premises and equipment, access to supplies?
- What method has the council used to ensure that these are charged at commercial rates to the trading company?

- Does the council intend to give the company a start-up loan? If so, are the terms of the loan the going commercial rate? How has this been determined? What other conditions (for example minimum capital requirements) are applied to the loan and have these been benchmarked against what a high street lender would require from a company seeking a loan of a similar size in a start-up scenario?
- What risk assessment has been made of the potential for the council to face challenges under competition law (state aid rules) in relation to its planned support?

3.3. Equality considerations

As part of its early decision-making process, the council must consider the possible equality implications of setting up a trading company – both for service users and for staff. Councils have an obligation under the equality duties to have "due regard" to the equality impact of any proposed decisions. There is no longer a specific requirement to complete an equality impact assessment, but this is the generally accepted method of complying with the duty.

Key questions to ask:

- Has there been an equality impact assessment of the proposal? Branches should ensure that they scrutinise any EQIA carefully checking for whether there is a proper assessment of what adverse impact on protected groups there might be from a move to a trading company – looking at both staff and service users. Check also for what assessment they have made of the ability of a trading company to advance and improve equality outcomes compared with an in-house or other service delivery model. (See Branch guide to: equalities in procurement)
- A trading company will not be covered by the public sector equality duty – will equality considerations be included as part of any contract or service level agreement with the company?
- How will the council ensure that the trading company promotes equality, tackles disadvantage and meets the diverse needs of the local community?

Equal pay

Branches should pay particular attention where the council proposes to hive off into a trading company a workforce which is predominantly female, or has a high proportion of black and ethnic minority staff. In these situations, business plans which appear to rely on a worsening of terms and conditions will disproportionately affect one group and should be challenged.

Furthermore, we know that some councils have seen moving female-dominated services such as social care into trading companies as a means of avoiding equal pay liabilities. As the women will no longer be employed by the council, the thinking is that they will no longer be able to compare their pay against male council workers. Branches in this situation should seek further advice from your Regional Organiser.

There are some situations in which a company may be deemed an 'associated employer' and therefore comparisons for equal pay purposes could still be made.

UNISON has recently won a case where the EAT said that for equal pay purposes UNISON members who were employed by an arms length trading company set up by Glasgow City Council could compare themselves with council employees.[5] The EAT commented that the ability to compare across associated employers is important to stop councils splitting up their workforce just to avoid equal pay comparisons. This is a complex area so you should seek advice early on.

3.4. Accountability and conflicts of interest

One of the areas many councils find problematic is how to retain accountability when a trading company is set up. A starting point is having council people on the board and forming a majority on it. If not, the council will effectively not have control over company decisions.

However it is not that simple. There is a more fundamental difficulty because company directors have a statutory duty to act in the interests of the company, not that of the wider council or public. This gives rise to potential conflicts of interest for council officers and/or elected members between the needs of the company and the needs of the council. It means that certain information they may be privy to in the course of their council role, should not be divulged or acted upon in their company role – a difficult square to circle.

Key questions for branches to ask:

- How would the council ensure that the company is accountable to the council and that its objectives are aligned to council policies?
- How would council officers and elected members handle conflicts of interest between their council role and their duty as company directors?
- What safeguards could be put in place to prevent company directors deciding to sell the company to private enterprise or a private equity owner?
- Will the company have clauses in its constitution guarding against the use of information by directors obtained in their council roles?[6]

Transparency

If the company is wholly owned by one local authority, it will be subject to the Freedom of Information (FoI) Act. However if it is co-owned by more than one council, it is exempt. Branches should note that in this case, much information is likely to be held by the council anyway so can be requested from them. However there may be information that cannot be obtained. And information will often be withheld on the grounds that it is 'commercially sensitive'. You should therefore push for a contract clause which would make the company subject to FoI Act requirements.

5 Fox Cross & Ors v Glasgow City Council & others UKEAT 0027-12-2501 (25 January 2013)

6 One council-owned company had an article in its constitution which stated that the directors must exclude from their minds and not mention at company board meetings, any relevant information which they had obtained in their capacity as council employees or councillors.

Trading companies are by nature less transparent because service delivery is not subject to scrutiny by way of meetings open to the public, and publication of all minutes and papers.

3.5. Does the business plan stack up?

There have been a number of examples of trading companies failing to achieve the revenue and business turnover projections upon which they were sold to councillors. This illustrates the tendency to 'talk up' additional revenue streams and 'play down' the additional costs to the council associated with setting up a trading company (see Chelsea Care and Essex Cares case studies – section 4).

Common areas of additional cost pressure for the council include consultancy fees, legal costs, procurement/tendering costs and contract monitoring costs.

Additional costs for the company include corporation tax, VAT, stamp duty and land tax, costs of bidding for work, marketing costs, charges from the council in respect of support, assets, supplies, higher borrowing costs and transaction costs.

- Ask the council if it has carried out a full taxation analysis.

Testing out assumptions

In many business cases UNISON has seen, there are a whole set of assumptions which amount to little more than guess-work. Here are some of the areas where, if one or more assumption is wide of the mark, it can make a huge difference to whether the proposed company a) looks viable and b) looks more advantageous than an in-house solution.

- **Overheads** – councils often under-estimate overheads because they are not charging all of the council's input back to the company
- **Supply chain** – councils sometimes claim that a company can make savings by sourcing its own supply chain. This lacks credibility because of the purchasing power that a council has across its services
- **Sickness absence** – councils often claim that a company will have a more commercial ethos and therefore be able to reduce sickness absence, without any real evidence to back the claim up. They fail to assess whether an in-house service could also reduce sickness absence through better management and health and safety practice. Any organisation which establishes a high degree of staff involvement and a supportive organisational culture, can create lower levels of sickness absence and higher levels of innovation and job satisfaction
- **New business** – councils often believe that they will be able to gain new business from other councils and from other local organisations, without any real commitments or detailed researched evidence. Try asking: 'who has the council spoken to, when and what commitments did they give to 'buy' from the council?' Once established, many trading companies have struggled to win work from elsewhere – especially when they are competing with large private sector companies which are experienced at tendering, have ready sources of commercial, legal and financial expertise to draw upon, and can afford to submit

'loss-leaders' (see Essex Cares case study)

- **Staff turnover** – councils often build a business plan on the assumption that labour costs will fall as TUPE-transferred staff leave the company and can be replaced by new staff on worse pay and conditions. In reality – and in the current labour market – there may not be as much turnover as they assumed, leaving costs exceeding forecasts (see Sefton New Directions case study). In addition, companies may experience higher staff turnover among new recruits because of their inferior pay and conditions, which carries a heavy cost in terms of recurring training and recruitment
- **Access to capital** – councils often believe they can assist the trading company with this but they do not always take account of the State Aid rules. Some councils make unrealistic assumptions about how the company could raise capital in today's financial market – a company's borrowing costs will be far higher than those of the council itself
- **Service delivery model** – is the proposed model for the company one that could be implemented in-house? Branches should talk to members about the plans for the company and gauge their views on the improvements proposed and whether they justify setting up a company

3.6. What if it goes wrong?

You need to ensure that you ask your council about what its exit strategy would be if the company went wrong. This is another question that may expose the shakiness of the business case and help you get a wider consideration of options. Remarkably many councils have proceeded without a clear idea of what they would do in the event of a failure.

- Would the council assume responsibility for debts that the company was unable to pay?
- Will the council commit to bringing services in-house if the company fails?
- What assessment of the costs of a company failure has been made by the council?
- What would the implications for service users be if the company fails and has to cease to trade?

3.7. Alternatives which work

It is important for branches to scrutinise and question a council's plans for setting up a trading company. There may be easier, cheaper and less risky ways of achieving the council's goals which it has not fully considered – often because of bad advice. You will want to make clear that the branch is not arguing for the 'status quo', but for a service improvement agenda that uses the most efficient and least risky way to deliver benefits for service users.

There are a number of alternatives which you can put forward and ask the council for a proper feasibility study of:

- **Powers to charge** – the council could charge for services (discretionary but not statutory) which are provided and delivered by the council's own workforce on a broad cost recovery (but non-profit-making) basis. It could charge for services provided to individuals, businesses and other organisations. Services can be

organised into in-house business units and commercial skills and expertise can be hired in if not already available. There are many successful direct labour/service organisations that do this. It is less risky than setting up a company and allows the council to test out how much potential external custom there is for its services.

- Review and streamlining of decision-making – many councils say they want to set up companies so staff can have greater freedoms and flexibilities in decision-making. Again this can just as easily be delivered by reorganising in-house services and devolving more decision-making and discretion to staff.
- Shared services and public-public partnerships – if the council mainly wants to obtain work from other public sector bodies, it is far easier to set up a joint committee under section 101 of the 1972 Local Government Act than to set up a trading company. In Scotland a joint committee can be designated a legal entity as in the case of Tayside Contracts in Scotland, which is run by three local authorities. In England, the Yorkshire Purchasing Organisation (YPO) operates as a joint committee of thirteen Yorkshire Councils. These are both good examples of municipal enterprise that have not required the establishment of a separate company. Because they are doing business with other public bodies and not in the wider market, there are no restrictions on how much work can be done or the generation of surpluses.
- Hybrid or 'shell' company – here the council's own work is kept in-house but external work (such as that carried out for private companies) would be channeled through a shell company and could be done on a commercial basis. No staff would transfer to the company but they could be seconded as and when, with a recharge to the company, to carry out work on commercial contracts that the company has bid for and won.

"Rather than some trading company models that 'suck up' the direct service organisations our model is designed to support in-house services, by allowing us to carry out additional work, at a profit, alongside the traditional works carried out by our inhouse services. This has a number of advantages."[7]

Head of construction services, Gateshead trading company

Key arguments branches can use:

Commercial expertise: It will be easier and cheaper for the council to hire people with commercial skills and expertise into its own services, rather than incur the costs of setting up a company which will then have to hire in those same people.

Flexibility in service delivery: priorities for service delivery in local government are changing rapidly under a number of cross-cutting pressures – including government policy, demographic changes, rationing of services, early intervention and prevention agendas and community empowerment. This means that hiving off certain activities into

7 APSE Case study: Gateshead trading company http://www.apse.org.uk/charging-trading/pdfs/dn-extracts/6-7.pdf

companies may lock the council into service delivery models which cannot be quickly altered to respond to new directions or pressures. It also institutionalises fragmentation of services which can work against integration of delivery (see ISSK Stockport services case study).

Control and accountability: Use of charging powers and/or public-public partnerships within an in-house delivery model allows the council to retain maximum control. The creation of a trading company automatically creates an entity which will have separate and possibly different interests to those of the council, and it may be difficult to maintain accountability (see Chelsea Care case study). Company directors could decide to sell the company on. Jobs, pay, pensions and conditions in the company are likely to be worse than the council's, affecting the local economy. The trading company could also decide to locate jobs outside the council's borders. If the company is competing for contracts, it may lose out to large corporate contractors and the council will then lose control.

Costs and risk: A separate company means a lot of extra costs for the council – at least initially. These include the costs of procurement, contract monitoring, tax liability and the Local Government Pension Scheme bond. The costs of failure – bailing out a failing company, or the consequences of not doing so – and the duty to step in as service provider of last resort, are all things that the council may also have to bear itself.

3.8. Negotiating issues if a trading company goes ahead

If – despite your best efforts – there is a decision to press ahead with a trading company, there are a number of staffing issues that you will need to address in your negotiations.

You may find your council:

- seeking to transfer staff from the council to the company
- seeking to second staff from the council to the company
- seeking to recruit new staff for the company (for example where the company is intended to trade in a new area which the council hasn't operated in before)

TUPE

The new UNISON guidance on TUPE transfers will give you practical and legal advice on what you need to know. You can find it at: www.unison.org.uk/file/21048.pdf

You should seek to negotiate a 'TUPE Plus' agreement which guarantees protection of terms and conditions, including an ongoing link to NJC and council agreements, for transferred staff. It should also ensure that there is no two-tier workforce, so new staff enjoy equal conditions with transferred employees. In Wales and Scotland the two-tier codes still exist which mean that councils should contractually require the company to give new starters pay and conditions no less favourable than transferred staff. But in England the code has been removed – so you will have to rely on what you can negotiate in the form of a TUPE Plus agreement.

A TUPE Plus agreement is also important in a commercial trading company because staff with TUPE rights may find themselves moving into work on a new contract or service areas beyond those transferred from the council. This could make it more difficult to enforce TUPE rights as time goes on.

Secondment

Seconding staff potentially gives staff more security as they retain their council employment but it needs to be done in a certain way – see UNISON guidance at: www.unison.org.uk/file/UNISON%20LG%20Secondments%20advice%20-%20final.pdf

Secondment agreements should be for the length of the contract, with a right to return to a comparable role in the council at the end of them. Secondment agreements should ensure appropriate consultation and negotiation rights for UNISON. Secondees who wish to take up other roles in the council – for example on promotion – should have the right to do so. You will still need an agreement to cover equal treatment for new starters who are brought in to work alongside seconded staff.

Pensions

It will be crucial to get agreement that the company will seek admitted body status in the Local Government Pension Scheme (LGPS). The new LGPS 2014 scheme for England, Wales and Northern Ireland will mean that all staff whose employment is compulsorily transferred, including under TUPE and subsequent TUPE transfers, will be able to retain membership of the LGPS when transferred. However the company will still need to commit to LGPS for new starters. Will the company be able to afford the pensions bond for LGPS liabilities?

Collective bargaining

You will need to secure a commitment to a union recognition deal with the company which makes provision for facility time for union reps within it. You should also seek agreement for council-employed union reps to use their facility time to represent members in the company – at least for a transitional period while union organisation develops. A company start-up period is a critical time where staff will need a lot of consultation and support. Adequate facility time from trained, experienced UNISON representatives will be crucial to success.

Staff and service user involvement

Ask the council about how it plans to ensure staff involvement and participation within the company. Will it offer a trade union seat on the Board? Will there be a works council? Will service users be represented on the Board? How will they be able to hold the company accountable for its services?

Exit strategy

Try to ensure that there is a written agreement on this and that it involves bringing the work in-house, with a no compulsory redundancy clause, rather than the council seeking to sell the company on. Staff are unlikely to fare well in the scenario where a trading company gets into difficulty and has to be sold to a private, or even private equity, company.

4. Case studies

Sefton New Directions

Facing a £3m funding cut from their £12m budget from the council, the Sefton New Directions local authority trading company proposed pay cuts averaging 12% rising to 28%, and up to 124 redundancies. It claimed that the terms and conditions with which staff had TUPE transferred from the council were now too expensive and there had been too few new starters. The Company are facing a further reduction in their funding from the council and a two year collective agreement ended in April 2013, resulting in further proposals for cuts to terms and conditions and jobs. The council has now decided to decomission some services, leaving the company facing heavy losses.

Chelsea Care

Chelsea Care was set up by Kensington and Chelsea Council (RBKC) in 2008 as a wholly owned trading company to provide home care and brokerage services in the borough. At the time it was felt that adult social care offered the 'best prospects for a council owned trading company'. The plan was to earn additional income by creating 'innovative' services that went beyond the council's core offer, namely practical care services and brokerage services for people with personal budgets.

Upon creation RBKC awarded Chelsea Care two three-year contracts – one for 350 hours of practical care services per week and one for brokerage services worth £250,000 per annum.

An ambitious operating income and expenditure forecast estimated that the first year would see an operating loss, before moving to a profit of nearly £123,000 within three years up to 2012. In order to achieve this it was forecast that the total income of the company would rise from just over £68,000 in the first year of trading to over £1.1 million by 2012.

After running ran into significant financial problems, Chelsea Care was put into liquidation in May 2011, when the council refused to inject further capital into the business to enable it to keep trading.

The forecasts made for the company turned out to be over-estimated, particularly around the growth in its private client base, which was one of the main reasons for setting up Chelsea Care. The number of new clients signing up was low, due to the level of competition in the market. Profit margins had been estimated to be 15-16% but were in reality closer to 3-4%.

Whilst staffing costs made up the bulk of Chelsea Care's costs, one of the biggest sources of predicted savings was through an 'employment model' which saw all staff on zero hours contracts, with home carers paid £6.15 per hour, and supervisors £7.50.

The Council's scrutiny board subsequently set up a working group to investigate what had gone wrong with the company and what lessons could be learnt. The working group produced a damning report cataloguing a series of failures in the way the company was set up and run[8]. They found that:

- No market research had been carried out to see if there was a viable market for the company's services

8 Cabinet & Corporate Services Scrutiny Committee: Liquidation of Chelsea Care (17th October 2011) http://www.rbkc.gov.uk/committees/Meetings/tabid/73/ctl/ViewMeetingPublic/mid/410/Meeting/5777/Committee/1415/Default.aspx

- No commercial business plan was drawn up until well into the company's existence
- There were no councillors on the board of the company, so there was no mechanism for monitoring and safeguarding the council's investment
- The 'wrong people' had been chosen to head up the company, with little commercial experience between them
- Accounts were not up to date and decision-making was not transparent
- The role of the main purchaser and the major shareholder (ie the Council) was 'confused'

By April 2011 the Council took the view that no improvement in the company's performance was likely. Along with the initial £150,000 equity to set the company up, the council had invested a total of £300,000, on top of paying for contracts worth £800,000. The report concluded that:

'Whilst [scrutiny committee] accepted the Council's deliberate wish to experiment and not to exercise direct control, they felt that insufficient vetting of the business plan at the start had been a fundamental mistake'.

Essex Cares

Essex Cares was set up in 2009 with the transfer of some 850 staff. While generally hailed as a success story, 2012 saw the company consulting on swingeing cuts to terms and conditions for sections of the workforce.

The initial contract with the county council was for three years, with a two-year extension. After that the company will have to bid against private companies for the contract, and staff may find themselves transferred to a private contractor.

Efforts to secure work from elsewhere are not proving straightforward. The company recently lost out to Serco in the race to secure a £140m deal to run community services in Suffolk.

Your Choice Ltd (Barnet LATC)

The Your Choice Ltd trading company was set up by Barnet council to run adult care services and began trading in 2012. At the time the council said that the company would return a small surplus in its first year rising rapidly in subsequent years.

In March 2013 the council announced that the company is in fact due to make a loss in its first year and that it has a £1m funding gap caused by a planned change from a block contract to one based on actual use, with payment in arrears. It proposes to take a 3 year loan from Barnet Homes, a sister company. The company is also consulting on redundancies and cuts to pay, terms and conditions in order to recover its shortfall. The UNISON branch has always challenged the evidence for the Business Case and the very optimistic profit forecasts claimed for the LATC.[9]

The branch's warnings now appear to be coming true and the company expects the workers to pay for the mistakes made by the council and company directors. The branch is campaigning against the proposals and calling for the services to be brought back in-house.

9 See: http://www.european-services-strategy.org.uk/news/2012/local-authority-trading-company-latc-for-adult/latc-analysis-2012.pdf

Individual Solutions SK (ISSK) – Stockport

ISSK was set up as a trading company owned by Stockport Council in 2009, with a view to making adult social care and support services more cost effective.

However by 2012 the council had serious concerns about both the value for money and quality of care of the company. It stated that the costs of the service were higher than expected and that the company was not performing in line with the projections made for it. Redundancies affecting around half the workforce were proposed.

The branch leapt to the defence of members and organised a strong campaign to oppose the job cuts.

A period of consultation led to a decision to take back in-house some of the key services that had gone out to the company – re-ablement, intermediate care and night support teams. The council cited significant changes in the focus of services which meant that the trading company was no longer appropriate:

"The direction of the Council's services within adult social care is moving towards a locality based integrated approach aimed at joining up council and health care to improve outcomes for older people...By focusing care around older people with the aim of maintaining them in their own homes for as long as possible there is a tremendous opportunity to align the high quality home support offered alongside the multi-disciplinary teams that are being created. It makes sense for the service to be a key part of the new integrated approach sitting alongside front-line social workers, district nurses and occupational therapists. This means that the current arrangement of having a separate company to deliver this aspect of care is not productive and there is more sense in ensuring all social care staff are part of one team and one system of referral and assessment."

The council also decided to review the potential for more services to return in-house and run alongside other in-house provider services, particularly the Learning Disability tenancies.

A joint project board comprising trade unions and managers from the council and ISSK was set up to oversee the transfer back in-house.

5. Sources of further information

Branches can access other relevant information at:

UNISON guide to procurement – see the UNISON website

UNISON TUPE branch guidance – www.unison.org.uk/file/21048.pdf

LGA Enterprising councils – getting the most from trading and charging 2012 edition – www.local.gov.uk/c/document_library/get_file?uuid=d72d82c9-0597-467c-be91-c32df1aa9e6d&groupId=10171

APSE: A diagnostic approach to service redesign – www.apse.org.uk/consultancy/pdfs/Diagnostic%20case%20study%20booklet.pdf

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