Flexible Contracts

October 2012 Briefing Number 16

At a time of financial uncertainty, Councils need maximum ability to respond to changes in their budgets. On the face of it, this is the worst time for tying funds into long term contractual commitments. Even where an arrangement with a contractor meets the needs of medium term financial planning, there can be no guarantee that it will continue to do so beyond the current plan period, or that unexpected reductions will not force the Council to reprioritise spending even within the medium term.

The One Barnet Programme risk register recognises that funding uncertainty is a threat to the success of the outsourcing approach. However, the Council maintains that it is possible to build 'flexibility' into contractual arrangements to mitigate the impact of unexpected cuts to funding.

It is not entirely clear what 'flexibility' means in this context but it must by definition be limited. The whole point of a contract is that it clearly establishes and guarantees the rights of its parties. If this were not the case commercial companies would not sink huge sums into the bidding process. Only the certainty of a contractually guaranteed income stream should they win, can justify bid costs of £1m plus.

There are a number of examples of contractual arrangements that have been based on a variable volume of work. So called incremental partnerships for example allow for varying levels of services to be transferred from a contracting authority to a private partner. Transfer of functions after the first tranche is often linked to the achievement of service and financial performance indicators. In other cases the contract might even allow for services to be taken back by an authority if circumstances warrant it.

The detail of contractual arrangements is rarely made public, so it can be difficult to fully understand how the arrangement is expected to work. The complexity of deals with varying volume can only add to the potential for an absence of clarity and the potential for surprising consequences when the Council attempts to take advantage of ‘flexibility’ clauses. Two current examples serve to demonstrate how these arrangements tend to work in the favour of the private partner. The first example is that of SW1 where Somerset County Council, because of government cuts, has been forced to cut the volume of work it passes to the company.

SW1 is jointly owned by the Council with Avon and Somerset Police, Taunton Deane Borough Council and IBM. IBM with a 75% share is by far the most significant player and is also SW1’s biggest supplier. The County Council planned to save around £100m through the SW1 deal by October 2012. Actual savings stand at a little over £13m. Despite this huge shortfall in savings the Council has now been forced to draw down a further £2.7m from contingency reserves to make up for what it terms, ‘a loss of unitary charge reduction’ pertaining to a clause in the contract that effectively penalises any reduction in volume. The net consequence of failing to get even close to planned savings has resulted in additional cost over and above the shortfall.

The second example is Cleveland Police Authority’s contract for so called back office services with Steria. This incremental contract explicitly linked the savings that Steria would deliver to the volume of work transferred. Restructuring when the transfer took place meant staff went into a redeployment pool. Due to the incremental nature of the contract, it was envisaged that as it developed there would be more work for these employees. But by August 2012, this had not happened. This means 30 posts will be lost, despite the contract being let on the basis of a guarantee of no redundancies for ten years.

The terms of the commercial agreement mean Cleveland police is forced to pick up the cost of redundancies. As an incremental model, the amount saved increases with the volume of work, which in this case did not occur, leaving the public sector to foot the redundancy bill. This situation reveals that the apportioning of risks and rewards between the public body and the private contractor was inherently unbalanced.

Barnet Council will no doubt learn from the mistakes of others and this will be reflected in the contracts it lets. However, it can never escape from the simple reality that private companies enter into these arrangements for entirely commercial reasons. For them it would be foolish not to protect their commercial interest by linking the level of savings to the volume of work transferred. The problem from the Council's perspective is that if it transfers less work than envisaged it will open a disproportionately large hole in its financial planning which will expand exponentially the more it tries to correct the problem by cutting the services concerned. In the case of Barnet, because of the sheer scale of its outsourcing programme, options to make savings in other ways will be severely restricted, leaving it little choice but to cut more deeply than would otherwise be necessary to make up for the impact of contractual penalties.

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