Creation of Delt Subsidiary Company

Background Briefing Report

PLYMOUTH CITY COUNCIL

1. Background

Delt Shared Services Ltd was set up to be what is commonly known as a 'Teckal' organisation. In accordance with current procurement law, this status enables local authority controlled companies to be directly awarded contacts by their local authority shareholders.

It is an exemption to the usual requirements that local authority contracts over certain values must be subject to open competition. Part of the requirements for this exemption is that shareholder activity / business undertaken by the company must amount to least 80% of the company's total business, usually assessed as an average over a consecutive three year period.

Remaining compliant with this exemption is important to the Council as a shareholder of Delt, as non-compliance could lead to the Council being successfully challenged for awarding a contract direct to Delt. This risk of challenge generally increases with the value of the contract.

2. The Problem

Delt has been successful in securing work from non-shareholders and without substantial support from the shareholders. The following table outlines the value of the shareholder and non shareholder activity of the company since 2021/22 and projected figures over the coming couple of years. It will be noted from the table that the ratio between shareholder and non shareholder business activity of the company has significantly increased since 2023. If the situation continues, from 2025 the shareholder contracts for services which the company would otherwise supply, will need to be competitively procured by the shareholder. The situation also opens up the risk of existing shareholder contracts being open to legal challenge.

Teckal Income Analysis – No Change

Year	Shareholder Income	3rd Party Income	3rd Party %	3rd Party Limit	Variance	3 Yr Av	Teckal Compliance
2021/22	17,658	1,685	8.7%	4,415	2,730		✓
2022/23	18,759	4,277	18.7%	4,645	368		✓
2023/24	20,354	5,516	21.3%	5,089	(428)	890	✓
2024/25	*20,942*	*5,716*	*21.4%*	*5,236*	*(481)*	*(180)*	✗
2025/26	*21,402*	*5,887*	*21.6%*	*5,351*	*(537)*	*(482)*	✗
2026/27	*21,850*	*6,028*	*21.6%*	*5,463*	*(566)*	*(528)*	✗

All values in £000's. *Numbers in Italics are forecast as at June 2024*

With the renewal of the Council's existing contract with Delt in 2024 for a further 10 years, it is in the company's and shareholders' interests (particularly the Council's) to remove any potential grounds for successful procurement law challenge prior to the new contract being entered into.

3. The Options

There are a number of alternative solutions to this problem:

1. New legal entity

Creation of an additional legal entity, that was not bound by Teckal. This has been achieved successfully in a number of similar entities, including Corserv, the Cornwall Council Trading company which operates a mix of Teckal and non Teckal companies. In this option, some or all of our existing non-shareholder work would be transferred (novation or assignment) to the NewCo. As a separate entity that is not required to be Teckal compliant, this company can undertake an unlimited amount of work for non-shareholders without issue. Legal and Financial analysis of this option has highlighted the risk of subsidy as an important consideration. The full cost of services delivered by the subsidiary company must be charged to their customers to avoid questions being raised about subsidy.

This option has the least impact on existing customers and shareholders, though the establishment of a new subsidiary of Delt would require an executive decision by the Council as a shareholder of Delt.

2. Increase Shareholder turnover

Increasing the amount of income from Shareholders (either existing or new) increases the Teckal limit by 20% of that income. Such increases could be achieved in a number of ways including:

- New contracts from new shareholders
- Increase in value of existing contracts from existing shareholders
- Transfer of additional services from existing shareholders
- Novation of additional contracts from existing shareholders

There are no new shareholders that could join the company in time to resolve the risk of procurement challenge. Equally, at present there are no additional services that the Council could buy from Delt or additional budgets that could be spent on existing services. The NHS are in a similar position. For this reason this option is not currently viable as a way forward to resolve the risk.

3. Route some 3rd party turnover through an existing shareholder

The option of routing some commercially contracted income via an existing shareholder has been explored and recently rejected. Some of Delt's commercial income is from a local NHS health provider. The option to route this income via the NHS shareholder was explored and ultimately rejected as the provider wanted a more direct relationship with Delt. No other option for routing revenue via a shareholder has been identified and therefore this option is not currently seen as viable way forward to resolve the risk.

4. Exit existing 3rd party contracts

Contractual break points have been considered by Delt to understand what might be possible. However, there are no options that could realise sufficient change in the percentage of commercial revenues fast enough to mitigate the risk. It is also recognised that exiting a contract could also create issues for clients currently reliant on Delt for services. For these reasons this option is not currently seen as viable way forward to resolve the risk.

4. Options Analysis

As described above only Option 1 offers a way forward that can effectively mitigate the risk as required by the Council. For this reason this option is the recommended way forward.

The recommended option will require a new company board to be established to oversee the subsidiary. It is proposed that the existing Delt board hold future meetings in 2 parts to consider the existing Delt company matters and then meet to consider matters related to the subsidiary.

Whilst the set up of the subsidiary company will help address the procurement requirements, the shareholders and the company appreciate they also need to ensure on going compliance with subsidy law requirements. In the latter regard the shareholders need to also ensure that any financial support they provide to the company and / or the subsidiary (directly or indirectly), does not place either company in an unlawful advantageous position when competing for further non- shareholder service contracts. The request to grant an officer delegation to address such matters, including arrangements to set up the subsidiary (e.g. approval of company documentation) will enable all matters to be resolved in a timely manner in the interests of the Council.