

**Warwick District Council - Sports and Leisure Programme**  
**Issues to consider when externalising the operation of WDC Leisure Centres**

The purpose of this paper is to provide a high level summary of the issues which the Council should consider when making a decision to externalise the management of its leisure centres to a private sector operator, as part of a full options appraisal. Understanding assets and liabilities are key to determining the financial viability of the externalisation option.

Externalisation of public sector services to the private sector can be challenging. Often delay or failure is caused by incorrect assumptions or unrealistic expectations. A fundamental assessment of what a Council is trying to achieve from any externalisation is essential at the start of the process.

It is essential to involve all relevant disciplines in the externalisation scoping work – service managers, legal, finance, HR, pensions, procurement, estates and property.

	<b>Key Considerations for WDC</b>
Procurement	<p>The Public Contracts Regulations 2015 and the European procurement directives will apply to any procurement of a private sector operator.</p> <p>Basic principles of equal treatment, transparency and competition need to be respected irrespective of which procurement procedure is followed.</p> <p>Pre-market engagement (soft market testing) is beneficial to understand the market's appetite for the Council's proposals. This has already been carried out in this case and the results were very positive.</p> <p>Financial assistance to operators (if not through the procurement process) may breach state aid rules.</p> <p>The tender process tends to take 9-12 months from advertising the tender to contract signature, with a short period of mobilisation thereafter. Costs and management/officer time are incurred</p>
Status of operator	<p>The Council will need to consider, through the tender process, the corporate governance structure, financial standing, reputation and business delivery model of an operator.</p> <p>The Council will need to be aware that operators owe duties to their shareholders/trustees which may sometimes conflict with the Council's objectives.</p>
WDC influence and direct control	<p>If the service is contracted out, the ability to make changes to the service is primarily in the hands of the operator, although the contract may be expressed to work "in partnership" (i.e. a collaborative approach) and will be subject to the agreed service specification.</p>
Contract Term	<p>Leisure operating contracts typically last up to 10 years (plus a possible 5 year extension) to provide service continuity.</p> <p>The Council will need to consider its preferred length of contract (whilst also considering what term might be attractive to bidders) and also whether it would like the opportunity for a contract extension (and, if so,</p>

	for how long).
Service Specification	<p>The Council's requirements will need to identified in the operating contract and service specification. A good specification is key to securing good value and an effective contract.</p> <p>The Council will need to set down its requirements on the operator to maintain, and hopefully, improve service delivery. Key Performance Indicators will need to be set down to ensure that the operator performs the services in accordance with the service specification and also to comply with other relevant industry standards and legislation.</p> <p>The Council will need to consider, within the specification, which services it may require from the operator during any centre property refurbishment process (if the contract starts prior to the refurbishment process being completed) and then thereafter during the contract lifetime.</p>
Contractual flexibility and change	<p>The Council will need to consider, within the specification and a change protocol within the contract, what level of contract flexibility is required that may permit the Council to add/remove other services to the contract.</p> <p>Changes/variations mid-contract may breach procurement rules depending on their significance – transformational change during a contract term is possible provided it has been contemplated at the outset of the procurement process.</p> <p>Operators may price for the risk or expect a break clause.</p>
Contract management	<p>The Council will need to consider its ongoing oversight and reporting requirements in relation to the service, including:</p> <ul style="list-style-type: none"> <li>• Operator reporting and liaison arrangements,</li> <li>• The consequences of the operator not providing the services to the required standard, through a remedy escalation process, and</li> <li>• Contract monitoring requirements – the Council will need to have in place a designated client officer to monitor contract performance.</li> </ul>
Payment provisions	<p>An established supplier market can provide competition on price and quality. Consider how the operator will charge the Council for managing the leisure services, for example:</p> <ul style="list-style-type: none"> <li>• A fixed-price basis,</li> <li>• A cost-plus basis (cost plus a certain margin),</li> <li>• A cost-plus with an element of sharing of risks and rewards basis, and</li> <li>• A part-fixed, part-variable basis (with a minimum commitment and a variable element in relation to differing volumes or service levels).</li> </ul> <p>Depending on the nature of the contract, it is likely in the current economic climate that the operator will pay the Council a contribution in</p>

	<p>order to be permitted to run the facility. They may also provide a share of profit. This will almost certainly apply if the planned refurbishment is undertaken by the Council.</p> <p>The Council will also need to consider:</p> <ul style="list-style-type: none"> <li>• Whether elements of the charges/payments should attract some sort of indexation (e.g. RPI) and how this is to be achieved,</li> <li>• Whether the operator will be under a duty to reduce costs each year or to make every effort to reduce costs during the life of the contract, and</li> <li>• Payment mechanisms.</li> </ul>
Share of operating surpluses	The Council to consider its expectations on the sharing of any operating surpluses between the operator and the Council.
Third party use and income	<p>The Council to consider:</p> <ul style="list-style-type: none"> <li>• The generation of third party income (clubs and events) throughout the contract lifetime, and who benefits, and</li> <li>• Any requirements or restrictions on third party use to represent the Council's values or to protect its reputation.</li> </ul>
Staff	<p>If the service is contracted out, the usual scenario is that existing staff transfer to the operator under the provisions of TUPE, however there may need to be some analysis on whether TUPE does apply to all staff engaged in the delivery of the service requirements, and if any central support staff are also subject to TUPE.</p> <p>If TUPE does apply, the Council will need to consider:</p> <ul style="list-style-type: none"> <li>• Its requirement to provide good quality TUPE information during the procurement process (the Council will have to pay for any TUPE risks which have not properly been understood),</li> <li>• What happens to any staff who choose not to transfer;</li> <li>• The effect of the staff consultation process on project timescales; and</li> <li>• TUPE transfers (and any redundancies) can be expensive and involve significant amount of management and officer time.</li> </ul> <p>A clear handover plan would need to be agreed with the new operator which covers staff engagement, union consultation, legislative requirements and practical aspects associated with payroll, HR policies, training and inductions.</p>
Pensions	<p>If TUPE applies, the Best Value Direction 2007 and the Fair Deal policy 2013 requires suppliers to make available LGPS membership or a broadly comparable scheme (presumption is LGPS).</p> <p>LGPS pension risks will need to be properly understood by the Council and by operators early in the procurement process. Pension risk sharing is a possibility. This is subject to approval by the LGPS Fund and by the Council.</p>
Utility Supply	<p>The Council to consider utility supply arrangements, including:</p> <ul style="list-style-type: none"> <li>• Whether it is best value for it, or the operator, to procure utilities</li> </ul>

	<p>based on current/future market movements and how any cost savings are shared between the parties,</p> <ul style="list-style-type: none"> <li>• Its existing contractual arrangements,</li> <li>• The sharing of risk in relation to utility costs, such as the operator is responsible for consumption risk and there is a shared position on tariff risk with the Council having responsibility for fluctuations in tariff, and</li> <li>• which party is responsible for complying with the Carbon Reduction Scheme.</li> </ul>
Step-in rights	The Council may want the right to step in to the contract and provide the services itself if the operator is faced with bankruptcy/organisational change, contract failure, if there is a serious health and safety risk, to discharge a statutory duty or because an emergency has arisen.
Assignment and sub-contracting	The Council to consider to what extent, if any, it would be prepared to permit the operator to assign or sub-contract out elements of the service (for example, catering, personal trainers, facility management and cleaning) and its required consent arrangements.
Indemnities	<p>Consider the circumstances where the Council would want to be indemnified by the operator – examples being against the typical exclusions of death or personal injury, damage to property, and third party claims against the operator's operation and management of the facilities.</p> <p>The Council, as freehold owner of some of the centres, would retain landlord/owner responsibilities.</p>
Disputes	<p>The Council to consider:</p> <ul style="list-style-type: none"> <li>• The use of standard dispute escalation procedures, and</li> <li>• The use of an industry mediator in any dispute.</li> </ul>
Termination	<p>The Council to consider:</p> <ul style="list-style-type: none"> <li>• The circumstances where it would want to terminate the contract and required timeframes,</li> <li>• Any compensation regime,</li> <li>• Seeking contribution from the operator for costs of re-tendering, and</li> <li>• Post-termination transfer arrangements (e.g. service, staff, contracts).</li> </ul>
Assets and liabilities	<p>Externalising a service involves a transfer of assets and liabilities.</p> <p>The Council to undertake due diligence to adapt the existing assets register and equipment inventory and assess:</p> <ul style="list-style-type: none"> <li>• Who owns current assets,</li> <li>• Who owns future assets,</li> <li>• Who maintains assets,</li> <li>• Who replaces assets,</li> <li>• ICT assets and software licensing and</li> <li>• Responsibility for dilapidations.</li> </ul>

	Liabilities previously undisturbed (e.g. premises, pensions) may become crystallised and will need funding.
Existing contracts	<p>The Council will need to consider the effect of externalisation on existing contracts, for instance:</p> <ul style="list-style-type: none"> <li>• Which contracts novate or are assigned over to the operator (as principle or agent). Example - vending machines,</li> <li>• The treatment of contracts where existing contractors do not want to contract with another party, and</li> <li>• The level of control that the Council wants over third party contracts (e.g. the promotion of healthy eating).</li> </ul>
Property issues	<p>The current proposal is that the Council will grant a long-term lease to the operator. Note that in usual arrangements, the lease does not contain any substantive provisions (e.g. in relation to repairs/maintenance/insurance etc). These are dealt with in the main contract and the lease refers back to that contract on such issues to avoid conflict between the documents</p> <p>The Council to consider:</p> <ul style="list-style-type: none"> <li>• Timeline – will the lease be granted before, during or after the refurbishment process,</li> <li>• Investigation of title,</li> <li>• Condition surveys and defects,</li> <li>• Necessary consents (including planning where applicable),</li> <li>• Car park arrangements,</li> <li>• Tax implications - the granting of a lease means that the contractor will be “in operation of the facilities” which may allow them to claim NNDR relief (see below under ‘Tax Implications).</li> </ul>
Protections and Security	<p>It is recommended that collateral warranties are obtained from the operator, given the intention that the Council will be offering a full repairing lease over some of its centres.</p> <p>The Council may also require the operator to provide a parent company guarantee or a bond if appropriate. This should be done at the outset of procurement so that they can be priced for as part of the bid process.</p>
Insurance	Consider who will insure the centres, assets and equipment (if applicable) – in many cases it may be better value for money for the Council (as freehold owner of some centres) to do so rather than the operator. This can be tested through procurement.
Tax	<p>The Council to obtain, as parts of the tendering process, tax advice on the implications of National Non Domestic Rates (NNDR) tax savings, and VAT.</p> <p>The provision of recreation (and hence leisure services) is currently defined as a charitable activity and exempt from many forms of taxation, including VAT.</p>
Data and Information	<p>The Council to consider:</p> <ul style="list-style-type: none"> <li>- The protection and use of staff and customer information, and</li> </ul>

	<p>operator compliance with FOI and DP,</p> <ul style="list-style-type: none"> <li>- Customer consents to the Council sharing information with operator,</li> <li>- Intellectual property rights,</li> <li>- Audit access,</li> <li>- WDC access to operator's records, and</li> <li>- Agreement on treatment of confidential information.</li> </ul>
Health and Safety	<p>The Council to consider its statutory requirements as freeholder owner of the leisure centres, and the operator's requirements as occupier.</p> <p>Also health and safety information sharing and indemnities.</p>
Risk	Operators expect payment for risk and for managing change.
Public Services (Social Value) Act 2012	This legislation applies to all contracts for service above EU thresholds – the duty to consider social value through the procurement of an operator and thereafter. This will be an important part of the procurement process.
Consultation and EIA	Customer/stakeholder consultation and Equalities Impact Assessment very likely to be necessary.
Facility handover arrangements	<p>The Council will want to identify its requirements on the operator for handover planning including:</p> <ul style="list-style-type: none"> <li>• Marketing and branding arrangements,</li> <li>• IT – transfer of electronic information, system compatibility,</li> <li>• Health and safety audits,</li> <li>• Programming and pricing policy arrangements – confirmation of transferring bookings, confirmation of any income due to the new operator relating to pre-payments for bookings/memberships, and</li> <li>• Arrange financial systems, including cash collection.</li> </ul> <p>This will apply also on contract expiry.</p>
'Boiler plate' provisions to protect WDC's interests	The council will want the inclusion of standard terms and conditions of contract including entire agreement, notices, severability, waiver, governing law and jurisdiction, sole remedy, counterparts and capacity.

**Warwickshire County Council Legal Services**  
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