Development & Regulatory Services (DRS)

& Risk

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People who support outsourcing as a strategy for the provision of public services often point to **'risk transfer'** as a compelling argument for using private contractors. They argue that, through the contract, the Council can have certainty about what a service will cost whilst the private company will have to pick up the bill if things go wrong. The concept is most applicable to construction contracts where cost and time overruns are common but it is also used as an argument to support the contracting out of services.

Risk and its effective analysis is a critical factor in any outsourcing venture. The most **obvious r**isk is that a contractor fails to do what is required of it under the contract. Supporters of outsourcing argue that **penalties** for poor performance mean that this risk is transferred to the contractor. However, penalties can only be applied after the failure has occurred and in the case of a contract for outcomes, such as Barnet DRS, the Council will only know that a **failure** has occurred once its impact has been felt. The more outcome oriented the contract is, the more this will be the case and whilst a mass outbreak of food poisoning may result in a failing environmental health contractor being penalised, this will do little to mitigate the impact on the people of Barnet. Given the sheer number of **critical services** within the DRS package, the cumulative impact of performance failure could be massive.

So, whilst **performance risks** can result in costs to the contractor, as in the recent case of **G4S** failing to supply adequate numbers of guards for the Olympics, the risk can hardly be said to have transferred. In the Olympics case, LOCOG had no choice but to pick up responsibility and they were only able to head off what could have been a show stopping failure, by bringing in the British Army. If the Barnet DRS contract fails in this way, there will be no such, 'in-house' capacity, to call on. This is why UNISON has consistently asked the Council to detail its contingency plans to cope in the event that the contract does fail. Given recent comments from Secretary of State for Culture, Olympics, Media and Sport, Jeremy Hunt: that it is, 'completely normal' for a contractor to fail on a major contract, this is now all the more urgent.

Performance risk is only one category of risk. **Commercial risks**, i.e. a contract not making as much money as expected, might be

expected to be fully borne by the contractor. However, there are numerous examples of how **commercial failure** on the part of the contractor rebounds on the contracting authority. This can be in the form of a catastrophic failure where the contractor goes out of business, as in the cases of Southern Cross and Connaught. It is more likely to be experienced as a contractor cutting costs through **underperformance** or often following the imposition of performance penalties, an attempt by the contractor to renegotiate terms, under pain of them walking away. Something like this recently happened to Barnet in relation to the contract for street lighting.

The DRS contract will take in a large number of services that are critical to the well-being of Barnet and its residents. The prospect of the provider of say, **environmental health, urban traffic control, planning, and dangerous structures** suddenly ceasing to trade creates an unprecedented level of dependence on a single supplier. This can only increase risks to the Council associated with the commercial failure of the contractor. Beyond requiring performance guarantees that might provide some level of financial compensation, the Council does **not** appear to have developed any **contingency** plans to cope with this risk.

Demand risk is a further category that is often used. In commercial terms it is the risk that the **volume of work** will be insufficient to keep the contract commercially viable. Aside from the obvious link with the commercial risk discussed above, there are some other implications for contracting authorities. The most significant is that bidders will always consider this a key risk and seek to mitigate it – usually by **linking** the volume of savings to the volume of work.

The impact of a contractor seeking to **mitigate demand risk** in this way can be seen in the contract that Somerset County Council has with the Joint Venture provider, **Southwest One**. Here, a reduction in volume, resulting directly from **government cuts** to the Council's budget, has resulted in what amounts to a penalty in the form of reduced savings. The result is that the Council will save only a fraction of the savings projected from the contract.

It is worrying that the **One Barnet risk register** considers future cuts in government grant to be no more than possible, when most people

would see them as more or less certain. This may mean that the Council will underestimate the risk that any future cuts will fall on whatever services still remain in-house.

The Southwest One example can also be used to illustrate how difficult it can be to meet future funding challenges once **substantial budgets are tied into long term contractual arrangements**. The private sector partner in the Joint Venture, IBM, agreed to a 5% reduction in charge for each service transferred from the County Council. This was on the basis that Southwest One, 75% owned by IBM, would be free to retain any savings arising from reducing staff numbers. This may have seemed a good deal when the contract was struck in 2007 but since then government cuts have been imposed at levels well beyond 5% and whilst Southwest One has managed to reduce staff by 25%, with consequent financial benefit to IBM, the amount that Somerset pays has remained at 2007 levels. Overall savings are far below what was envisaged but even if they had materialised at projected levels, they would still not have been enough to meet the cuts in government grant. In these circumstances a public authority has no choice but to look for savings elsewhere but **options are vastly reduced** when large chunks of the budget are contractually committed.

All outsourcing carries risk with it. The extent to which risk can be transferred to the private sector is debatable but recent experience indicates how the public can often be left to **pick up the pieces** when things go wrong. Outsourcing to a **Joint Venture** means that some risks – particularly those relating to the commercial success or otherwise of the venture, are purposely shared. Provided that this is fully understood and that the risks are proportionate to the potential rewards, the decision to participate in such an arrangement may be entirely justified. Unfortunately, in Barnet's case there is no indication that risk has been fully assessed and as yet, no indication of what the Council stands to gain from the proposed DRS Joint Venture. IT is therefore difficult to see how members can make an **informed decision.**

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