

Future Delivery Model for the Highway Maintenance Service

Report of the Chief Executive

Please note that the following recommendations are subject to consideration and determination by the Cabinet (and confirmation under the provisions of the Council's Constitution) before taking effect.

1) Recommendation

That the Cabinet be asked to:

- a) approve the Future Delivery Model for the Highway Maintenance Service as a core Term Maintenance Contract supported by a series of other Contracts;
- b) delegate to the Director of Climate Change, Environment and Transport in consultation with the Cabinet Member for Highway Management authority to progress the procurement process, through to tender evaluation, with contract award by Cabinet in the Summer of 2026, including a review of the scope, term, and specification for the contracts with oversight by the Corporate Infrastructure and Regulatory Services Scrutiny Committee;
- c) Recognise that further investment is required in the road network and that this is considered through the budget setting process from 25/26 onwards;
- d) consider the funding of up to £1.3m set-up costs over the period up to April 2027 as detailed in Appendix 4 section 7, through the annual budget setting process;
- e) endorse discussions with Dorset Council on collaborative working on the procurement process, and delegate to the Director of Climate Change, Environment and Transport in consultation with the Cabinet Member for Highway Management authority to progress this if agreed .

2) Background / Introduction

The County Council's Highway Term Maintenance Contract with Milestone Infrastructure terminates in March 2027 with no options to further extend the contract. The current contract through which the Council commissions routine, reactive, emergency, and some planned highway maintenance work, started in April 2017 and over its 10 years will have had a value of over £400 million. As such it is one of the largest contracts the County Council commissions.

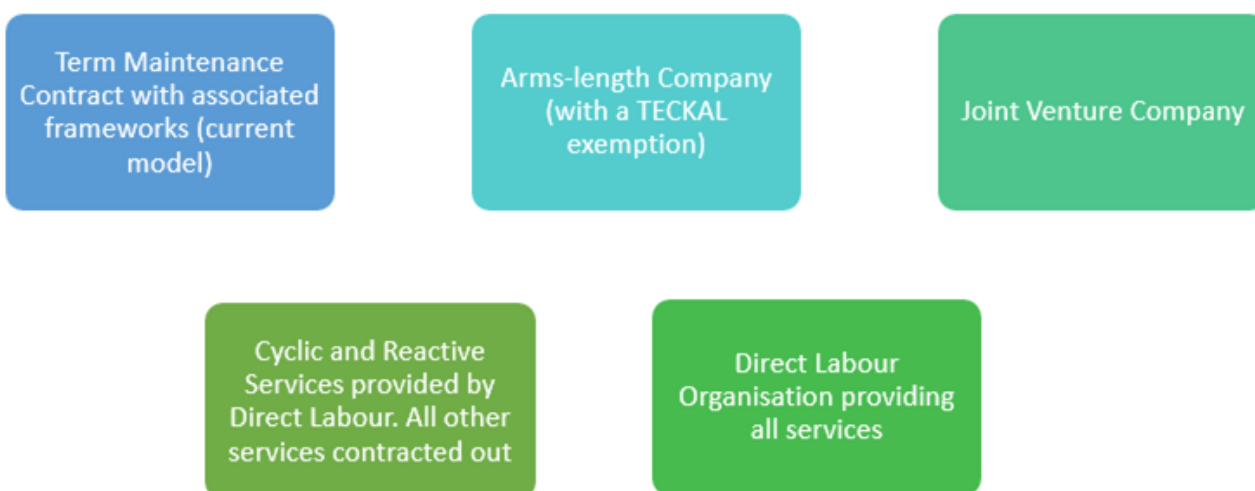
The County Council's current Delivery Model for the Highway Maintenance Service is a combination of the Term Maintenance Contract, complementary Frameworks and Termed Contracts delivering planned works, and an In-House Design Service.

This report explains the work that has been undertaken on how the overall Highway Maintenance service could be delivered beyond March 2027, considers the short list of 5 Delivery Model options, and recommends the preferred future Delivery Model.

From discussions with Members there is a clear frustration in the current condition of the network, particularly the carriageway asset. When explored further, it is often the case that the frustration is linked to decisions based on County Council policy or procedures which is linked to the long term under funding as opposed to the performance of the contractor. The current maintenance backlog is in excess of £200m and continues to grow. This is against a national backlog that is estimated to have reached £16.3bn.

3) Option Assessment

Details of the process to select the shortlist of five options is contained in the Project Business Case in Appendix 4. The list of 5 Delivery Model options to be considered further is.



The Teckal exemption is a legal principle that allows public authorities to award contracts to a separate legal entity without following public procurement rules provided specific conditions are met with regard to control and ownership.

Since the initial development of the short list, it is felt that there is insufficient time to establish and mobilise a Joint Venture Company ahead of the end of the current contract in March 2027. As such this option has been discounted.

A Project Business Case (Appendix 4) has been produced and this outlines cost estimates of the ongoing annual financial values of the significant issues including profits, taxation, pensions and buying power. In addition, it has looked at the likely one-off upfront costs associated with establishing the various options.

As well as costs, the Business Case considers the County Council's varying exposure to risk and liability associated with the different models.

This options assessment process has identified that the cost differences between establishing and operating the various models is limited but a Term Maintenance Contract limits the exposure to risk for both the County Council and by extension the residents of Devon and is therefore the preferred option.

4) Options

When a similar exercise was carried out approximately ten years ago the preferred option was a **Term Maintenance Contract** to deliver the core functions of the Service including safety defect repairs, cyclic operations (gully emptying and grass cutting), winter service and emergency response (road traffic incidents and severe weather events). This Contract was then supported with a series of **Framework Contracts** with a mix of specialist and smaller, local contractors that deliver additional patching and surfacing operations, drainage improvements and specialist operations including surface dressing or replacement of roadside barriers.

While the Term Maintenance Contract model is subject to the risk of the volatility of the market at the time of tender it does not expose the County Council to the risks associated with works delivery, including potential high cost personal injury or health & safety risks, as well as identifying and recruiting a new management team. By employing an experienced contractor to undertake the delivery aspect of the works the risks around claims and the day-to-day management of high risk construction and maintenance operations are not carried by the County Council.

The Project Business Case in Appendix 4 considered the potential buying power that a relationship with a contractor that is part of a much bigger organisation offers. It is thought that a Term Maintenance Contract might offer as much as £2m of additional benefit through reduced rates to the County Council. The wider financial differences between the models is considered in Section 9.

An **Arms–Length Company** (with a Teckal exemption) would require the establishment of a new contracting organisation that would be wholly owned by the County Council. The new company would be the employer of all the management team and operatives responsible for delivering the works. The company would retain the ability to sub-contract the operation to others through a public procurement process, similar to the County Council.

In order to establish this new organisation, the County Council would need to strengthen its commercial and contracting expertise through recruiting additional staff. This additional team would be required well in advance of the expiry of the current contract in order to ensure the necessary commercial relationships with the supply chain are in place for April 2027. There is a risk that individuals with the appropriate mix of skill and experience required to form this team are not available in the currently highly competitive recruitment market.

An **Arms–Length Company** would see the County Council holding the ultimate liability for the operational risks associated with the management of the maintenance function of the highway network which are complex and substantial. The most significant of these risks is personal injury claims for negligence that may have led to multiple fatalities on the highway network. In addition to this, the day-to-day management of a workforce of circa 240 operatives working in a high-risk environment brings with it considerable risk to the authority and would likely be one of the largest risks for the Council. Statistics published by the HSE for 23/24 show that the second most common kind of fatal incident to a worker was being struck by a moving vehicle.

This model is impacted by the local government accounting rules that prevent certain internal overhead costs being capitalised. This would result in an effective reduction in revenue budget of up to £2m.

An **All In-House** option would see all of the highway maintenance operations being managed and delivered by a Direct Labour Organisation with staff directly employed by the County Council. The County Council would retain the ability to establish framework contracts to deliver certain work streams, specialist operations or provide additional capacity.

An **All In-House** option carries the same risks as an Arms-Length model in relation to the substantial health & safety risks and potential for personal injury claims, but would also see the additional risks and costs associated with the transfer of approximately 240 operatives and a management team of just over 90. This would require the County Council to manage the up-front transfer of this workforce in line with the TUPE legislation.

While an Arm's Length company has flexibility to determine a competitive remuneration package, staff employed directly by the County Council are subject to the existing pay arrangements which are uncompetitive against the private sector and set nationally, and therefore outside of the Council's direct control to change. The ability to pay incentives or allowances is also considerably less flexible within the Council due to existing nationally negotiated Terms & Conditions, coupled with an active Trade Union environment.

This staff group are exposed to very significant risks which are well in excess to those experienced by the current Council workforce. The risk of routinely working on a live carriageway is very high and often cannot be eliminated through road closures. The level of risk would likely be in the top 3 of the Council's Risk Register. In addition to the 'working on the carriageway' risk, staff will also be exposed to noise, vibration, dust to a much greater extent than our current workforce. Provision will need to be made for routine medicals, and regular monitoring and risk assessments. There are potentially other risks around the carcinogenic nature of some of the materials used on the highway that may require monitoring and control. It would also bring with it issues around risk mitigation relating to the urgency of work being carried out, short notice planning, working at night, and working in poor weather conditions. Whilst the Council is exposed to these risks in a small way, bringing this staff group in-house will massively increase this risk exposure.

There is a significant risk that the current organisation does not have the current capacity, both within the People & Culture and Legal & Democratic Services Directorates to manage the significant workload associated with this transfer. In addition to the up-front transfer, the direct employment of circa 240 operatives would likely bring a significant additional ongoing workload to both the People & Culture Directorate and Legal & Democratic Services Directorate in relation to Health & Safety, insurance, performance and risk management, at a time when their resources are limited and focusing on existing organisational challenges.

The 2008 Pension Act requires that all employees are auto-enrolled to the Local Government Pension Scheme (LGPS). When compared to the pensions being offered within the private sector this would likely generate a significant increase in the cost of labour as the current minimum rate for employers' contribution is 3%, whereas the LGPS scheme is 21.8% of salary. Whilst this is very attractive to staff, it would be a considerable cost for the Council. The additional ongoing costs for maintaining this contract are outlined in Table

2 in the Finance Section and are over £2-3 million higher per annum for this option than the other options, of which the pension costs form part of.

A variation on the All In-House option would be for **Cyclic and Reactive Services** to be provided **In-House** through a smaller Direct Labour Organisation with all other services contracted out through framework agreements. This option carries the same risks as the In-House option albeit to a lesser degree due to the smaller scope and scale of the in-house delivery element.

5) Risk Management Considerations

The balance of risk is one of the key factors in determining the Future Delivery Model. The option which holds the least risk for the organisation and therefore the tax payers of Devon is a Term Maintenance Contract.

There are inherent risks associated with the maintenance of live highway assets. These risks relate to the safety and performance of the workforce, the volatility of the construction and highway maintenance business sector, as well as the safe use of the network by the travelling public.

Establishment Risks

The risks can be broken down into different categories. Before the operational phase there are a series of risks or challenges with the initial set-up of each of the options that place a lesser or greater risk burden on the County Council. The table below highlights the challenges associated with each model.

TABLE 1 LIABILITY FOR ESTABLISHMENT RISKS

Risk	Joint Venture	All In-House	Cyclic and Reactive In-House	Arms-Length Company	Term Maintenance & Framework Contracts
Challenging to deliver within timescale and risk of failed procurement	✓				
Need to strengthen commercial / contracting expertise		✓	✓	✓	
Impact on revenue budget of overhead costs		✓	✓		
Market prices at time of tender	✓		✓		✓

Contractors' overhead costs are included in charges for work and funded from capital or revenue budgets as appropriate. Local Government accounting rules prevent certain internal overhead costs being capitalised, so the In-House options would result in an estimated increase of up to £2m in revenue costs per annum, and an equivalent reduction

in capital costs. This would impact on the amount of reactive work (e.g. drainage jetting or siding & ditching) delivered from the highway revenue budget.

Operational Risks

The most significant risks associated with the management and delivery phase:

- Personal Injury claims (including up to multiple fatalities)
- Insurance claims (eg damage to car tyres and wheels)
- Third party claims liability for non-performance and damage
- Poor quality resulting in remedial work
- The efficiency of performance in delivering the contract for the tendered price
- Management of the supply chain
- Inflation
- Variation in budget

An assessment of the potential impact of these risks to the County Council can be seen in the table below. Consideration has been given to the potential impact on the County Council's finances, reputation, resources and exposure to litigation.

TABLE 2 ASSESSMENT OF IMPACT OF OPERATIONAL RISKS

Type	Potential Severity			Likelihood	Impact
	Financial	Reputational	Legal		
Personal Injury Claim	Very High	Very High	Very High	Low	Very High
Insurance Claim	Medium	High	Medium	High	High
Third Party Claim	Medium	Medium	Medium	Medium	Medium
Poor Quality of Workmanship	Medium	High	Low	High	High
Efficiency of Delivery	High	Medium	Low	High	High
Supply Chain Management	Medium	High	Low	High	High
Inflation	Medium	Medium	High	High	High
Variation in Budget	Medium	Medium	High	High	High

The various delivery models place the liability for these different management and delivery risks either with the contractor, with the County Council or share the risk. The table below lays out which party would carry the liability for each risk for each delivery model.

TABLE 3 LIABILITY OF RISK FOR EACH DELIVERY MODEL

Type	Type of Risk	Joint Venture	All In-House	Cyclic and Reactive In-House	Arms-Length Company	Term Maintenance & Framework Contracts
Personal Injury Claim	Claims	Shared	Devon CC	Devon CC	Devon CC	Contractor
Insurance Claim						
Third Party Claim						
Poor Quality of Workmanship	Delivery	Shared	Devon CC	Devon CC	Devon CC	Contractor
Efficiency of Delivery						

Supply Chain Management						
Inflation	Finance	Shared	Devon CC	Devon CC	Devon CC	Contractor
Variation in Budget						

6) Consultations

A market engagement questionnaire has been made available to the supply chain, and promoted through the regional Contractors Association, to identify their views on issues including preferred type and length of contract, and the range of work they would like to see included, if it is decided to procure contracts for the service. The results of the survey are detailed in the Background Paper “Market Engagement Report” and will contribute to the development of any contractual procurement.

Exploratory discussions have been held with the highway authorities listed at Appendix 2. This includes authorities on similar contract timescales to Devon, and those operating the Delivery Models that are being considered in the short list.

Dorset Council, which current operates a Cyclic and Reactive In-House model, is on a similar contract timescale, and has expressed an interest in working with Devon on the procurement process if the Term Maintenance Contract option is chosen.

7) Corporate Infrastructure and Regulatory Services Scrutiny Committee

A Scrutiny Members’ Masterclass was held on 18 April 2024, to which all Members were invited, to explain the work that has taken place on the options appraisal, together with providing details and answering questions on the short list of Delivery Model options. To aid the discussion a short questionnaire was distributed in advance of the Masterclass for Members to indicate what they feel are the most important attributes of any future Delivery Model.

The 27 June 2024 meeting of the Scrutiny Committee considered report CET/24/44 explaining the work that has been undertaken on option appraisal and considering in detail the assessment of the short list of Delivery Model options. The Committee also considered the results of the Members’ survey regarding the most important attributes of a Future Delivery Model as summarised in Appendix 3 and heard evidence from Senior Managers from neighbouring authorities on operation of In-House and Arms-Length Company models. It was resolved that a further report be brought to the Committee’s next meeting on an outline business case, prior to consideration by Cabinet (detailing costs including TUPE, pensions, reactive work components; savings; full market effects, shareholder dividends, value for money, tax and other issues included in the risks and opportunities analysis), for the respective delivery model options and for the further consideration of attributes.

A second Scrutiny Members’ Masterclass was held on 10 September 2024, to which all Members were again invited and 23 attended, to explain the detail of the work undertaken on preparing an outline business case for the short list of Delivery Model options, and answer Members’ questions. The business case at Appendix 4 outlines cost estimates of the ongoing annual financial values of the significant issues including profits, taxation, pensions and buying power. In addition, it has looked at the likely one-off upfront costs

associated with establishing the various options and has considered the risks to both establishing and operating the models.

The 25 September 2024 meeting of the Scrutiny Committee subsequently considered report CET/24/65 detailing the business case. The Committee considered this additional information, together with the information contained in report CET/24/44 and resolved that Cabinet be advised:-

(a) that Members' ranking of the most important attributes of a Future Delivery Model for the Highway Maintenance Service as summarised in Appendix 4 to Report (CET/24/44) and set out below (in order of importance) be confirmed:-

1. Quality of work
2. Value for money
3. Managing performance
4. Information on work programmes
5. Response to changing demand
6. New technology and innovation
7. Level of risk to County Council
8. Climate change response
9. Achievability of transition;

(b) that having considered the financial and risk information in the outline business case at Appendix 1 to Report (CET/24/65), together with the information contained in report (CET/24/44), Scrutiny Committee's view on the short list of 5 Delivery Model options (in order of preference) were as follows:-

- | | |
|-----------|---|
| 1st | Direct Labour Organisation providing all services (i.e. All In-House option) |
| 2nd | Cyclic and Reactive Services provided by Direct Labour. All other services contracted out |
| Joint 3rd | Term Maintenance Contract with associated Framework Contracts (current model) |
| Joint 3rd | Arms-Length Company (with a Teckal exemption) |
| 5th | Joint Venture Company; and |

(c) that it is recommended that this Scrutiny Committee take a role in overseeing preparations for the new contract or organisation and its delivery.

8) Corporate Resource Considerations

Whichever option is chosen for the future Delivery Model there will be resource implications for corporate support services including Procurement, HR, Legal, ICT and Finance. Key issues identified have been discussed in the assessment of options at section 4, and the impact on the corporate services is summarised at Appendix 4.

When considering the future Delivery Model, it is essential to take into account the other challenges that the wider County Council is dealing with and will be addressing in the medium to long term. The impacts on the People & Culture Directorate, Finance & Public Value Directorate and Legal & Democratic Services Directorate of bringing delivery in

house either via All In-House, Cyclic and Reactive In-House or through the establishment of an Arms-Length organisation are too high for the organisation to consider.

A Term Maintenance Contract supported by a series of Framework contracts minimises the demand on the various corporate resources.

9) Strategic Plan

No specific considerations have been identified regarding the Strategic Plan priorities in assessing the Delivery Model options, as any decision on Delivery Model does not alter service levels or policies.

The Highway Asset Management Plan provides the guidance on the implementation of the County Council's Highway Maintenance service. The Council's 'Best Place' priorities flow through this Plan, with '**Respond to the Climate Emergency**' being a strong example of this. Through work with Exeter University a real-time reporting tool for construction work emissions is being developed. This will help to understand total emissions and identify carbon hotspots areas. In turn this will offer the information needed to make informed decisions on where to reduce emissions. A further example is how The Plan through its maintenance activities addresses the priority to '**Help Communities to be Safe, Connected and Resilient**'. In addition to the strong emphasis on Network Safety the Service is continuing to promote community self-help schemes and volunteering. This is particularly important to enable a local response to highway needs that would otherwise not be addressed.

10) Financial Considerations

Delivery of the Highway Maintenance Service is funded from revenue and capital budgets. In 2023/24 the combined spend was £94.7m and the value of the work that has been delivered through the current Term Maintenance Contract was £52.5m.

Whichever Delivery Model is chosen there will be significant additional costs over the next 2 years preparing and procuring contracts or setting up companies / organisations. External legal and financial advice, staffing a project team and ICT hardware and systems will form a major part of these costs, which are estimated to be up to £3.3 million depending on the Delivery Model chosen. The funding for this will be considered for the latest revision of the Medium-Term Financial Plan.

The Project Business Case in Appendix 4 includes an assessment of the potential costs associated with the establishment of each option and the ongoing annual financial values of the significant issues identified in this analysis. The purpose of this assessment is to highlight the differences between the options to inform the decision-making process rather than as a detailed estimate of total costs.

A summary of these costs can be found in the tables below.

Table 1 Estimated establishment costs

	External Legal and Financial Advice	Project Team	ICT hardware, systems, and management	TUPE, property services and contingencies	Total
Joint Venture	£0.9m to £1.1m	£0.4m	£0.1m	£0.4m	£1.8m to £2.0m

All In-House	£0.1m to £0.2m	£0.6m	£0.6m	£0.6m	£1.9m to £2.0m
Cyclic and Reactive In-House	£0.1m to £0.2m	£0.6m	£0.4m	£0.6m	£1.7m to £1.8m
Arms-Length Company	£0.5m to £0.7m	£0.6m	£1.3m	£0.7m	£3.1m to £3.3m
Term Maintenance and Framework Contracts	£0.4m to £0.6m	£0.4m	£0.1m	£0.2m	£1.1m to £1.3m

Table 2 Estimated ongoing annual cost to County Council of identified issues.

	Contractors' Pre-tax profit	Employer pension contributions	Buying power (Additional costs for plant and materials)	Total
Joint Venture	£0.6m to £1.1m	£0.5m to £1.3m	Nil	£1.1m to £2.4m
All In-House	Nil	£3.6m	£0.6m to £2.1m	£4.2m to £5.7m
Cyclic and Reactive In-House	£1.0m to £1.7m	£1.3m to £1.9m	£0.6m to £2.1m	£2.9m to £5.7m
Arms-Length Company	Nil	£0.5m to £1.3m	£0.6m to £2.1m	£1.1m to £3.4m
Term Maintenance and Framework Contracts	£1.3m to £2.3m	£0.5m to £1.3m	Nil	£1.8m to £3.6m

Table 2 shows that the models with elements of in-house delivery have the highest ongoing annual costs, leading to a potential reduction in service levels.

While there are differences between the various models, it is important to recognise that these differences are within an overall budget spend that is currently approaching £100m and will increase through the life of the model.

The condition of the highway network continues to deteriorate due to sustained under investment. This has resulted in an asset that is extremely fragile. The additional money that has been invested this year is welcomed, but there is a need for a continuous investment in the road network to attempt to get to a steady state. The frustrations of Members and the general public are often linked to the County Council's policies or working practices rather than the delivery model or the performance of the contractor.

11) Legal Considerations

The lawful implications/consequences of the Delivery Model options have been considered and taken into account in the preparation of this report. Whichever Delivery Model is chosen, external legal advice and support will be required on preparing and procuring contracts and/or setting up a corporate vehicle.

The proposed Future Delivery Model of a core Term Maintenance Contract supported by a series of other contracts is the option which carries the least risk to the Council in relation to

potential personal injury claims for negligence, as this risk would sit with the Contractor. In the other appraised options, this risk would either be shared between DCC and the Contractor (Joint Venture model) or sit wholly with the Council (In-house or Arms-Length Company). In particular, the In-House model would carry significant risks and pressures to the Council's budget and it would be highly likely to increase our insurance premiums.

12) Environmental Impact (Including Climate Change, Sustainability and Socio-economic) and Equality Considerations

Where relevant, in coming to a decision the Equality Act 2010 Public Sector Equality Duty requires decision makers to give due regard to the need to:

- eliminate discrimination, harassment, victimisation and any other prohibited conduct;
- advance equality by encouraging participation, removing disadvantage, taking account of disabilities and meeting people's needs; and
- foster good relations between people by tackling prejudice and promoting understanding

in relation to the protected characteristics (age, disability, gender reassignment, marriage and civil partnership (for employment), pregnancy and maternity, race/ethnicity, religion or belief, sex and sexual orientation). This Council also treats care experience as if it were a protected characteristic.

A decision maker may also consider other relevant factors such as caring responsibilities, rural isolation or socio-economic disadvantage.

In progressing this particular scheme / proposal, an Impact Assessment has been prepared which has been circulated separately to Cabinet Members and also is available on the Council's website at <https://www.devon.gov.uk/impact/published>

Members will need to consider the Impact Assessment for the purposes of this item / meeting.

In choosing the future Delivery Model for the Highway Maintenance Service, it is not proposed to alter service levels, policies, or levels of funding. The Impact Assessment has therefore focussed on the level of influence the County Council would have over the following impacts for each of the short list of 5 Delivery Model options.

Equality - discrimination against staff delivering the Highway Maintenance Service

Environmental – reuse and recycling of materials, minimising greenhouse gas emissions and pollution, reducing water consumption.

Economic – impact on local businesses.

The County Council would have most influence over these impacts with the In-House or Arms-Length Company options, and least control with the Term Maintenance Contract option where it would be relying on contractual requirements and conditions.

13) Summary

A detailed assessment process following national guidelines has been undertaken to identify the preferred option to deliver the highway maintenance service beyond April 2027. Over the last 6 months the short list of options has been taken through the Scrutiny process including two Members' Masterclasses and reports to two CIRS Scrutiny Committee meetings.

While it is recognised that seven members of the CIRS Scrutiny Committee expressed a preference for the In-House delivery model, the model that reduces the exposure of risk to the County Council and by extension the residents of Devon is a Term Maintenance Contract with a series of supporting Contracts. There were no votes against a Term Maintenance Contract at the CIRS Scrutiny Committee.

If this recommendation is accepted as the preferred option it will be subject to a full review of the scope of the contracts (what work streams sit with either the Term Maintenance or Framework Contracts), the length of contract and the terms as well as the works specification. The contracts will also require a full, competitive procurement process in line with the Procurement Act 2023 (due to come into force on 24 February 2025) to select new suppliers. The selection criteria would be determined based on the County Council's priorities and as requested, the CIRS Scrutiny Committee would consider this process as it progresses.

Appendix 6 details the planned timeline thorough to April 2027.

Donna Manson

Chief Executive

Electoral Divisions: All

Cabinet Member for Highway Management: Councillor Stuart Hughes

Local Government Act 1972: List of background papers

Background Paper	Option Assessment Report
Date	January 2024
File Reference	Option Assessment Report Link
Background Paper	Market Engagement Report
Date	February 2024
File Reference	Market Engagement Report Link
Background Paper	Reports to Corporate Infrastructure and Regulatory Services Scrutiny Committee
Date	27 June 2024 and 25 September 2024
File Reference	CET/24/44 and CET/24/65
The above-mentioned Reports are published on the Council's Website	
https://democracy.devon.gov.uk/ieListMeetings.aspx?CId=427&Year=0	

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Appendix 1 to CET/24/xx - Short list of Delivery Model options - Assessment

Joint Venture

Forming a legal Joint Venture Company with a contracting partner

Strength	Weakness
Financial performance partnership. Sharing of profits. Contractor's commercial knowledge.	Not currently used nationally. Providers expressed little appetite. Sharing of risk. Legally complex and costly to set up and unwind. Complex procurement process. Complexity for communications and reputation management.
Opportunity	Threat
Close collaborative working Legal backing and buy in from partner.	Relationship with partner. Challenging to deliver within timescale and risk of failed procurement. Potential Corporation Tax liabilities with external advice needed.

Appendix 1 to CET/24/xx - Short list of Delivery Model options - Assessment

All In-House

Creating an In-House Direct Labour Organisation for delivery of the Service, with nothing contracted out.

Strength	Weakness
<p>Performance within County Council control.</p> <p>Control of overhead costs and no profit element to fund.</p> <p>Could reuse existing IT with some enhancements.</p> <p>No procurement process or service agreement is required.</p>	<p>Complexity and cost of transition including TUPE considerations.</p> <p>LGPS employer contributions.</p> <p>County Council would take the burden of all risk.</p> <p>Need to strengthen commercial / contracting knowledge.</p>
Opportunity	Threat
<p>Ability to deliver strategically important aims.</p> <p>Flexibility to amend scope of work in delivery.</p>	<p>Significant increase in establishment.</p> <p>Recruitment of workforce and retention.</p> <p>Expanding into current specialist framework contract services.</p> <p>Ability to offer commercial incentive package.</p> <p>Lack of buying power.</p> <p>Ongoing procurement for plant, equipment, and supplies.</p> <p>Accounting rules prevent internal overhead costs being funded from capital. Potential substantial increase in revenue costs.</p>

Appendix 1 to CET/24/xx - Short list of Delivery Model options - Assessment

Cyclic and Reactive In-House

Cyclic and Reactive Services provided In-House.

All other services contracted out.

Strength	Weakness
Generally as “All In- House” plus Business for local construction market. Framework contracts are attractive.	Generally as “All In- House” plus More complex transition. More complex and demanding governance. Resilience to support varying demands across seasons and emergencies.
Opportunity	Threat
Generally as “All In- House” plus Expanding scope in future.	Generally as “All In- House”

Appendix 1 to CET/24/xx - Short list of Delivery Model options - Assessment

Arms-Length Company

Forming a Local Authority owned and controlled Arms–Length Company

Strength	Weakness
<p>Performance within County Council strategic control.</p> <p>Control of overhead costs and no profit element to fund.</p> <p>Market salary, benefits, and incentive packages.</p> <p>“Teckal” exemption from procurement.</p>	<p>Complexity and cost of transition including TUPE considerations.</p> <p>External legal and financial advice on set up.</p> <p>County Council would take the responsibility of all risk.</p> <p>Need to strengthen commercial / contracting knowledge.</p> <p>Most complicated from ICT perspective to implement and transition data.</p> <p>Complexity for communications and reputation management</p>
Opportunity	Threat
<p>Commercial opportunity for income.</p> <p>Options to include other marketable services.</p> <p>Market level pension contributions.</p> <p>Option of initially providing core services.</p>	<p>Limited evidence of model being used currently nationally.</p> <p>Disparity between pay and benefits package for client and delivery staff.</p> <p>Lack of buying power.</p> <p>Potential Corporation Tax liabilities.</p> <p>Possible ongoing procurement for plant, equipment, and supplies.</p> <p>Restricted by public procurement rules to purchase goods, services or works.</p>

Appendix 1 to CET/24/xx - Short list of Delivery Model options - Assessment

Term Maintenance and Framework Contracts

Procuring a new Term Maintenance Contract supplemented by Framework Contracts

Strength	Weakness
<p>Tried and tested delivery model.</p> <p>Market interest.</p> <p>Balanced share of risks with contractor.</p> <p>Competitively procured.</p> <p>Business for local construction market.</p>	<p>Market pricing and include for risk, overheads, and profit.</p> <p>External legal support on procurement and contract.</p> <p>Procurement to be repeated at end of contract requiring significant resources.</p>
Opportunity	Threat
<p>Redevelop contract in line with current requirements.</p> <p>Contractor input to innovation and new technology.</p> <p>Buying power of large commercial organisation.</p>	<p>Long term competitiveness of contract price.</p> <p>Contract discourages flexibility.</p>

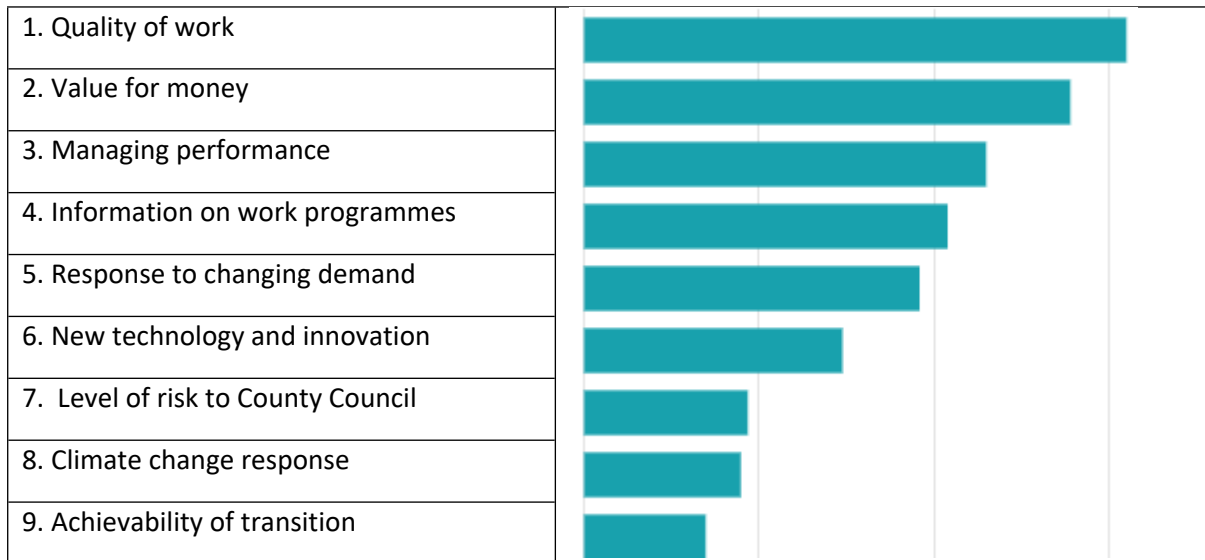
Appendix 2 to CET/24/xx - Local Authority discussions

Authority	Comment
Suffolk County Council	Extensive Term Maintenance Contract. Recently procured
Essex County Council	Integrated Service Provider Contract. Expires March 2027.
Dorset Council	Direct Labour Organisation plus Term Maintenance Contract for planned works. Expires March 2027
Torbay Council	Arms-Length Company. Includes waste collection, recycling and grounds maintenance.
Plymouth City Council	Term Maintenance Contract. Expires March 2027
Cornwall Council	Arms-Length Company. Includes grounds maintenance and design services.

Discussions have also taken place with WSP who have experience in mobilising and operating a Joint Venture Company

Appendix 3 to CET/24/xx

Attributes of a Future Delivery Model ranked in order of importance to Members, with the most important at the top.



Analysis of the 18 responses received.

PROJECT BUSINESS CASE

Purpose: <i>The purpose of the project is to appraise options for future delivery of the Highway Maintenance Service and take the assessment of the options through the Scrutiny process and make a recommendation on the preferred option to Cabinet for approval.</i>	
Project Title: <i>Future Delivery Model for the Highway Maintenance Service</i>	
Document Version No: 01	Document Ref: 240712 Outline business case.doc
Author: Tony Matthews	Date: July 2024

Document History

Revision Date	Summary of changes	Version Issued	Project Sponsor sign-off

1. REASONS

The County Council's Highway Term Maintenance Contract with Milestone Infrastructure terminates in March 2027 with no options to further extend the contract.

The Highways and Traffic Management Service is taking the opportunity to review the choice of Delivery Model to ensure it best meets the future needs of both the organisation and users of Devon's network.

2. OPTIONS

An initial list of 17 delivery model options have been assessed by officers from the Highways and Traffic Management Team and Procurement Team in a series of workshops following the Future Highways Research Group methodology. The options were scored on how each model would contribute to the delivery of the Service's nine Strategic Goals, and how attractive (value for money) and achievable they are against 13 factors.

2.1. Shortlist Criteria

Strategic Goals

- Strengthen Financial Resilience
- Use insights from data to improve performance and inform what we do.
- Work with Communities to understand needs and clarify what we can do.
- Deliver Social Value.
- Recruit and retain a resilient and empowered workforce where diversity is valued.
- Maintain, operate and improve our highway network and infrastructure for all users.
- Develop and improve the service using best practice, emerging technology and innovation.
- Deliver our contribution to the climate emergency response.
- Protect and enhance our natural and historic environment.

Attractiveness Analysis (VfM)

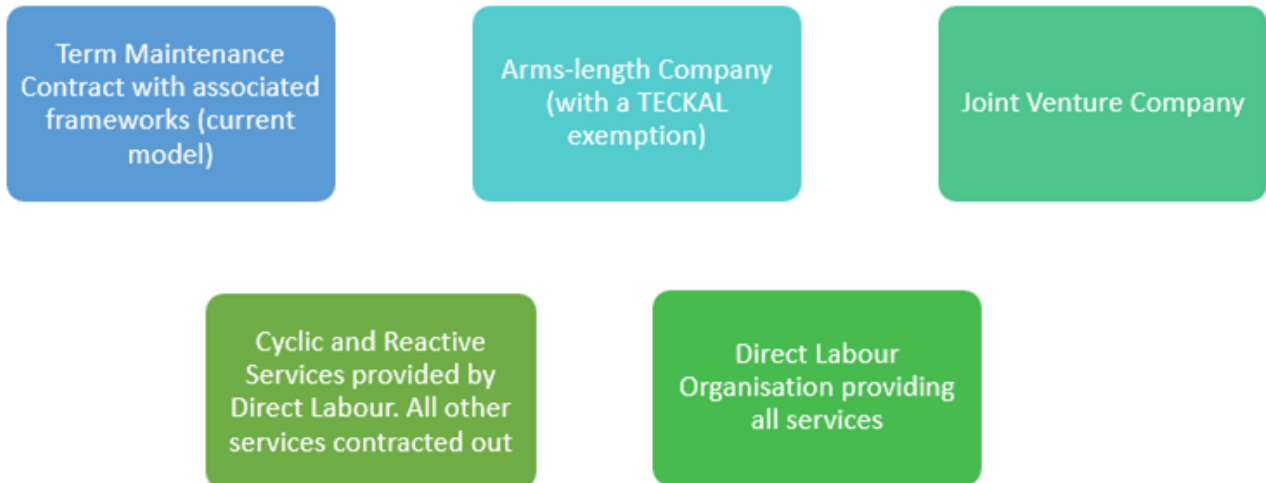
- Economy
- Efficiency
- Effectiveness
- Stakeholder value

Achievability Analysis

- Complexity (inherent risk)
- Capability and Capacity
- Affordability
- Authority Readiness
- Provider Readiness
- Sector Success Stories

- Governance and Reporting
- Partner Management
- Cultural Alignment

This work has identified a clear short list of 5 Delivery Model options to be considered further.



2.2. Description of Options

When a similar exercise was carried out approximately ten years ago the preferred option was a **Term Maintenance Contract (TMC)** to deliver the core functions of the Service including safety defect repairs, cyclic operations (gully emptying and grass cutting), winter service and emergency response (road traffic incidents and severe weather events such as the ‘Beast from the East’). This TMC was then supported with a series of framework contracts with a mix of specialist and smaller, local contractors that deliver additional patching and surfacing operations, drainage improvements and specialist operations such as surface dressing or replacement of road side barriers, etc.

If the TMC model was the preferred option beyond 2027 it would be subject to a full review of the scope of the contract (what work streams sit with either the TMC or framework contracts), the contract terms and the specification that the contractor needs to meet. The contract would also require a full, competitive procurement process to select a new supplier.

An **Arms–Length Company** (with a Teckal exemption) would require the establishment of a new contracting organisation that would be wholly owned by the County Council. The new company would be the employer of all the management team and operatives responsible for delivering the works. The company would retain the ability to sub-contract the operation to others through a public procurement process, similar to Devon County Council.

An **All In-House** option would see all of the highway maintenance operations being managed and delivered by a Direct Labour Organisation with staff directly employed by the County Council. The County Council would retain the ability to establish framework contracts to deliver certain work streams, specialist operations or provide additional capacity.

A variation on the All In-House option would be for **Cyclic and Reactive Services** to be provided in-house through a smaller Direct Labour Organisation with all other services contracted out through framework agreements.

A **Joint Venture Company** would see the County Council establishing a new company with a contracting partner selected through competitive procurement and negotiation. This arrangement would be based on the partners sharing all profits/losses and liabilities. While this option was shortlisted, as of August 2024 it is thought that there is insufficient time to select a partner and establish a new company ahead of the end of the current TMC in March 2027. As such this option has been discounted but included in this process for completeness and transparency.

3. FINANCIAL CONSIDERATIONS

Through the option assessment workshops, liaison with other highway authorities, and advice from County Council support services, an assessment of the Strengths, Weaknesses, Opportunities and Threats of the 5 identified options has been made as summarised in Appendix 1 of the report to Corporate Infrastructure and Regulatory Services Scrutiny Committee [CET/24/44](#).

An assessment has been made of the potential costs associated with the establishment of each option and the ongoing annual financial values of the significant issues identified in this analysis.

3.1. Profits

Based on the average pre-tax profit margin¹ of the top 100 UK construction companies over the last few years a potential range for the annual cost to the County Council of the profit element of contracted out work has been estimated. It has been assumed that a Joint Venture would be on a 50/50 profit share basis, and that the All In-House and Arms-Length Company options would operate on a cost recharge basis, with no contracted out or sub contracted services.

3.2. Taxation Considerations

Companies and Limited Liability Partnerships (LLP) are subject to different statutory regulation than Local Authorities e.g. Companies Act 2006 and Limited Liability Partnerships Act 2000 and different accounting regimes to those of the public sector. A company or LLP would be liable for tax on any profits or gains on disposal of business assets produced in any year. Corporate Tax is payable by companies on profits and gains as assessed by taxation legislation for each fiscal year. The current rates for Corporate Taxation depend on the assessed profits:

Profits <£50,000 Tax rate 19%
 Profits >£250,000 Tax rate 25%

UK Local Authorities are exempt from Corporation Tax on their income and exempt from Capital Gains Tax.

The impact of taxation of the delivery model options are summarised below.

Joint Venture	A Joint Venture could be established through setting up a limited company or through the creation of a LLP. Profits of a limited company would be subject to Corporation Tax on any profits or net gains from the disposal of business assets in any fiscal year. With a LLP the profits or losses revert to the partners to be dealt with in the way that they are normally taxed, and Local Authorities are exempt from Corporate Taxation.
All In-House	In-House activity is exempt from Corporate Taxation.
Cyclic and Reactive In-House	In-House delivery of Cyclic and Reactive Services would be exempt from Corporate Taxation. Contractors providing all other services are obliged to account for taxation according to their own corporate status, and there are no taxation implications for the County Council through placing contracts for services.
Arms-Length Company	It has been assumed the company would operate on a cost recharge basis. However, as a limited company, albeit wholly owned by the local authority, any profits or net gains from disposals of business assets would be liable to Corporate Taxation.
Term Maintenance and Framework Contracts	Contractors are obliged to account for taxation according to their own corporate status, and there are no taxation implications for the County Council through placing contracts for services.

3.3. Pension Contributions

With the In-House options the workforce and staff would be auto enrolled into the Local Government Pension Scheme, in which the employer contribution rate² is significantly higher than the typical market contribution rate for a construction company pension scheme³. An estimated range for the annual cost of employer contribution has been produced for the workforce and staff to deliver the Highway Maintenance Service. If some of the All In-House option work is contracted out or sub contracted, the cost of the employer contribution for this option would be proportionally less.

The effect is to increase the cost of the labour associated with both the All-In House and Cyclic and Reactive In-House delivery models.

3.4. Buying Power

An In-House operation or Arms-Length Company would be a relatively local medium sized commercial operation when compared with the national or multinational companies likely to be interested in a TMC. As an example, in delivering the existing TMC, Milestone Infrastructure annually spends £6m on plant and fleet, and £7m on materials. Whilst spend for M Group, their parent company, is £125m on plant and fleet, and £340m on materials, which provides them with the opportunity to negotiate and leverage reduced prices.

Milestone Infrastructure have provided examples of the discount rates they achieve in the annual spend on materials and plant through the buying power of M Group, when compared to the prices available to a smaller operation. This is potentially an extra cost for the In-House and Arms-Length Company options, and an estimate of the potential range of this annual cost is shown in the following table.

TABLE 3 ESTIMATED ONGOING ANNUAL COST TO COUNTY COUNCIL OF IDENTIFIED ISSUES.

	Contractors' Pre-tax profit	Employer pension contributions	Buying power (Additional costs for plant and materials)	Total
Joint Venture	£0.6m to £1.1m	£0.5m to £1.3m	Nil	£1.1m to £2.4m
All In-House	Nil	£3.6m	£0.6m to £2.1m	£4.2m to £5.7m
Cyclic and Reactive In-House	£1.0m to £1.7m	£1.3m to £1.9m	£0.6m to £2.1m	£2.9m to £5.7m
Arms-Length Company	Nil	£0.5m to £1.3m	£0.6m to £2.1m	£1.1m to £3.4m
Term Maintenance and Framework Contracts	£1.3m to £2.3m	£0.5m to £1.3m	Nil	£1.8m to £3.6m

3.5. Cyclic and Reactive Costs

To aid understanding of the Cyclic and Reactive In-House option the Committee requested a breakdown of labour, materials and plant costs for this work stream. The analysis of cost of work undertaken directly by Milestone Infrastructure in 2023/24 for Cyclic and Reactive Work (including grass cutting, gully emptying, drainage, reactive patching, siding, emergency response, safety defects and winter service) compared with Planned Work, is as follows:-

TABLE 4 BREAKDOWN OF COSTS ASSOCIATED WITH CYCLIC AND REACTIVE WORKS

	Cyclic and Reactive Work	Planned Work
Labour	43%	23%
Inspectors / designers	5%	<1%
Plant	31%	25%
Materials	21%	52%

These figures do not include work undertaken by sub-contractors.

3.6. Value for Money

An assessment of the value for money of each model option in delivering the Highway Maintenance Service

TABLE 3 CONSIDERATION OF VALUE FOR MONEY OF EACH DELIVERY MODEL

Joint Venture	Contract prices and the corporate vehicle arrangements would be subject to competitive tender (which could involve an element of negotiation) in the open market. Any profits would be shared with the contracting partner.
All In-House	<p>The efficiency and effectiveness of a newly formed In-House organisation would depend on the management and monitoring regime the County Council wishes to implement, and the balance targeted between issues including costs, quality, and flexibility.</p> <p>Due to accounting rules, the overheads associated with managing and operating the company would be considered a revenue burden as opposed to capital.</p>
Cyclic and Reactive In-House	Similar comments to the All In-House option for Cyclic and Reactive works. Contract prices for the rest of the work would be subject to competitive tender in the open market (which could involve an element of negotiation).
Arms-Length Company	The efficiency and effectiveness a newly formed Arms-Length Company would depend on the management and monitoring regime the County Council wishes to implement, and the balance targeted between issues including costs, quality, and flexibility.
Term Maintenance and Framework Contracts	Contract prices would be subject to competitive tender (which could involve an element of negotiation) in the open market.

4. NON-FINANCIAL CONSIDERATIONS

The non-financial issues are included in the assessment of the Strengths, Weaknesses, Opportunities and Threats for the 5 Delivery Model options summarised in Appendix 1 of the report to Corporate Infrastructure and Regulatory Services Scrutiny Committee [CET/24/44](#).

Members have identified Quality of Work as one of the most important attributes of a Future Delivery Model. The specification that lays out the standards for quality is built on national publications, with modification for local preferences. This document would be common across each of the models. The 'employer's requirements' that expands the specification, defines the full scope of the works, and embeds the County Council's policies would again be similar across each model.

The TUPE regulations would also apply to each of the models and see the majority of the workforce currently delivering the Service transferring to the new contractor / organisation.

5. RISKS

The risks during the procurement, negotiation and mobilisation for the various options were considered in the assessment of the Strengths, Weaknesses, Opportunities and Threats summarised in Appendix 1 of the report to Corporate Infrastructure and Regulatory Services Scrutiny Committee [CET/24/44](#).

5.1. ESTABLISHMENT RISKS

The risks can be broken down into different categories. Ahead of the operational phase there are a series of risks or challenges with the establishment of each of the various options that place a lesser or greater burden on the County Council. The table below highlights the risks associated with each model, and where they would be held by the County Council.

TABLE 4 LIABILITY FOR ESTABLISHMENT RISKS

Risk	Joint Venture	All In-House	Cyclic and Reactive In-House	Arms-Length Company	Term Maintenance & Framework Contracts
Challenging to deliver within timescale and risk of failed procurement	X				
Need to strengthen commercial / contracting expertise		X	X	X	
Impact on revenue budget of overhead costs		X	X		
Market prices at time of tender	X		X		X

Contractors' overhead costs are included in charges for work and funded from capital or revenue budgets as appropriate. Local Government accounting rules prevent certain internal overhead costs being capitalised, so the In-House options would result in an estimated increase of up to £2m in revenue costs per annum, and an equivalent reduction in capital costs. This would impact on the amount of reactive work (e.g. drainage jetting or siding & ditching) delivered from the highway revenue budget.

5.2. OPERATIONAL RISKS

The most significant risks associated with the management and delivery phase:

- Personal Injury claims (including up to multiple fatalities)
- Insurance claims (eg damage to car tyres and wheels)
- Third party claims liability for non-performance and damage
- Poor quality resulting in remedial work
- The efficiency of performance in delivering the contract for the tendered price
- Management of the supply chain
- Inflation
- Variation in budget

An assessment of the potential impact of these risks to the county council can be seen in the table below. Consideration has been given to the potential impact on the county council's finances, reputation and exposure to litigation (*or impact on Legal/HR resources).

TABLE 5 ASSESSMENT OF IMPACT OF OPERATIONAL RISKS

Type	Potential Severity			Likelihood	Impact
	Financial	Reputational	Legal		
Personal Injury Claim	Very High	Very High	Very High	Low	Very High
Insurance Claim	Medium	High	Medium	High	High
Third Party Claim	Medium	Medium	Medium	Medium	Medium
Poor Quality of Workmanship	Medium	High	Low	High	High
Efficiency of Delivery	High	Medium	Low	High	High
Supply Chain Management	Medium	High	Low	High	High
Inflation	Medium	Medium	High*	High	High
Variation in Budget	Medium	Medium	High*	High	High

The various delivery models place the liability for these different management and delivery risks either with the contractor, with Devon County Council or share the risk. The table below lays out which party would carry the liability for each risk for each delivery model.

TABLE 6 LIABILITY OF RISK FOR EACH DELIVERY MODEL

Type	Type of Risk	Joint Venture	All In-House	Cyclic and Reactive In-House	Arms-Length Company	Term Maintenance & Framework Contracts
Personal Injury Claim	Claims	Shared	Devon CC	Shared	Devon CC	Contractor
Insurance Claim						
Third Party Claim						
Poor Quality of Workmanship	Delivery	Shared	Devon CC	Shared	Devon CC	Contractor
Efficiency of Delivery						
Supply Chain Management						
Inflation	Finance	Shared	Devon CC	Shared	Devon CC	Contractor
Variation in Budget						

6. IMPACT ASSESSMENT

An Impact Assessment to be considered by Cabinet has been prepared, providing an equality, environmental and economic analysis of the short list of options. In choosing the future Delivery Model for the Highway Maintenance Service, it is not proposed to alter service levels, policies, or levels of funding. The Impact Assessment has therefore focussed on the level of influence the County Council would have over the equality, environmental and economic impacts for each of the short list of 5 Delivery Model options.

7. SET UP COSTS

Whichever Delivery Model is chosen there will be significant additional costs over the next 2 years preparing and procuring contracts or setting up companies / organisations. External legal and financial advice, staffing a project team and ICT hardware and systems will form a major part of these costs.

Table 7 Estimated establishment costs

	External Legal and Financial Advice	Project Team	ICT hardware, systems, and management	TUPE, property services and contingencies	Total
Joint Venture	£0.9m to £1.1m	£0.4m	£0.1m	£0.4m	£1.8m to £2.0m
All In-House	£0.1m to £0.2m	£0.6m	£0.6m	£0.6m	£1.9m to £2.0m
Cyclic and Reactive In-House	£0.1m to £0.2m	£0.6m	£0.4m	£0.6m	£1.7m to £1.8m
Arms-Length Company	£0.5m to £0.7m	£0.6m	£1.3m	£0.7m	£3.1m to £3.3m
Term Maintenance and Framework Contracts	£0.4m to £0.6m	£0.4m	£0.1m	£0.2m	£1.1m to £1.3m

There is potential for significant upfront capital investment for plant and fleet with the In-House and Arms-Length Company options. However, currently Milestone Infrastructure leases plant and fleet, and it is assumed these leases would be able to be transferred if an In-House or Arms-Length Company option is progressed, avoiding upfront capital investment.

8. SUMMARY

At the June 24 CIRS Scrutiny Committee Members were presented with report [CET/24/44](#) that included a 'SWOT' analysis for the 5 options short listed through the Future Highways Research Group model.

This business case has expanded on the previous information by providing cost estimates of the ongoing annual financial values of the significant issues identified in the SWOT analysis. In addition, it has looked at the likely one-off upfront costs associated with establishing the various options.

The range of ongoing annual costs is £1.1m to £5.7m (£4.6m)
 The range of one-off set up costs is £1.4 to £3.6 (£2.2m)

These costs need to be considered in the context of approximately £80m of annual spend which over the life of the chosen model could be in excess of £1bn.

In addition to the financial considerations the report has considered the various risks to both establishing and operating the various models. The liability for these risks can sit with either the contractor or Devon County Council through the choice of delivery model. The delivery model that has the fewer risks, both for establishment and operation, is the Term Maintenance and Framework Contracts.

References

¹ *theconstructionindex.co.uk* "Top 100 Construction Companies 2023"
Institution of Civil Engineers "Where do Tier 1 contractors make their money?"

² *Peninsula Pensions 2024 rate*

³ *Examples from three highway contracting companies operating in the Southwest.*

Appendix 5 to CET/24/xx - Impact on Support Services

	HR	Legal	ICT	Finance	Procurement
Joint Venture	Little impact if Company uses own HR service	Significant external legal resource required for procurement negotiation and drafting contract.	Low to medium impact. Either party could provide the ICT but both options are a manageable risk.	Potentially complex tax considerations May require external support.	Significant resource for complex lengthy process to identify the best provider, followed by negotiation.
All In-House	Transferring of over 300 staff through TUPE, including enrolment in pension scheme, and ongoing support to additional staff.	Relatively limited legal support required for set up but there will be a need for more ongoing legal support.	Low risk and impact. Removes risk of data sharing, GDPR breaches, integration of systems with external partners.	Would significantly increase the number of invoices processed. Potential impact on cashflow considerations.	No procurement of delivery model, but ongoing procurement of plant, goods, and services
Cyclic and Reactive In-House	Similar to All In-House	Relatively limited legal support required for set up but need for more ongoing legal support.	Low to medium impact. Could mean 2 methods for delivery of ICT are required.	Would increase the number of invoices processed. Potential impact on cashflow considerations.	Procurement of new Framework Contracts and ongoing procurement as All In-House
Arms-Length Company	Transfer of some County Council staff to Company. Little other impact if Company uses own HR service	External legal resource required in setting up Company and drafting contract.	High to medium impact. ICT could be complex.	Potentially complex tax considerations May require external support.	No procurement of delivery model, but possible ongoing procurement of plant, goods, and services

Term Maintenance and Framework Contracts	Little impact	External legal resource required for procurement negotiation and drafting contract.	Low to medium impact. Possible mobilisation investment setting up or integrating to new systems.	No material changes.	Significant resource for competitive procurement of new Term Contract and Framework Contracts
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There are also potential impacts for Communications and External Affairs from the Joint Venture and Arms-Length Company options.

Future Delivery Model for the Highway Maintenance Service

Timeline to commencement of new model (Go Live): 1st April 2027

Date	Duration	Start
Term Maintenance and Framework Contracts		
Prepare Contract Documents	10 Months	Oct 24
Tender Period	5 Months	Aug 25
Tender Assessment and Award	6 Months	Jan 26
Cabinet approval to award		Jul 26
Mobilisation	9 Months	Jul 26
Go Live		Apr 27
Arms-Length Company		
In-House options		
Recruit Management Team	12 Months	Jan 25
Establish New Organisation	12 Months	Jul 25
Mobilisation	9 Months	Jul 26
Go Live		Apr 27