


27. NEW MAINTENANCE CONTRACTS



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PURPOSE OF REPORT

1. The purpose of the report is to seek a decision to enter into negotiations with City Care Limited (City Care) in respect of 3 groups of maintenance contracts that have expired, or will expire, between now and 2011. These cover assets administered by the Greenspace, Water and Waste, and Facilities Maintenance Units.

EXECUTIVE SUMMARY

2. Since 1999 City Care has been awarded contracts for some of the maintenance work required in respect of the Council's core assets. Details are set out in a report in the public excluded portion of this agenda.
3. Those contracts either have expired or are due to expire over the next few years.
4. City Care is a Council Controlled Trading Organisation (CCTO). All of its shares are held by Christchurch City Holdings Limited (CCHL). The Council's interest in City Care (through CCHL) is listed as one of the Council's strategic assets in its 2006-16 LTCCP.
5. For this and other reasons set out in this report, it is recommended that the Council enter into negotiations with City Care for new contracts to replace those due to expire.

FINANCIAL IMPLICATIONS

6. City Care is monitored by Christchurch City Holdings Limited. Its financial results are included in the Council's group accounts. Confidential information about the effect on City Care of it losing the contracts City Care currently has with the Council are provided separately in the public excluded portion of this agenda.
7. It is likely that any decision to award contracts to companies other than City Care would affect not only the financial position of that organisation but also that of the Council group.
8. If the recommendations contained in this report are adopted by the Council it is proposed that the Chief Executive, Tony Marryatt, be authorised to appoint a panel for the purpose of entering into negotiations with City Care. It is proposed that this group comprises both internal and external members and that it is chaired by a suitably qualified external consultant. This is to provide an independent assessment that any terms and conditions agreed upon by the Council and City Care will give value for money and are fair to both parties.
9. If Council supports this report's recommendations, it is intended that Simpson Grierson (Mike Weatherall) be retained as an external advisor with regard to the process for negotiating with City Care and the completion of the appropriate documentation, should that be the ultimate outcome of those negotiations.

Do the Recommendations of this Report Align with 2006-16 LTCCP budgets?

10. The cost of maintaining assets owned by the Council is provided for in its budgets.

LEGAL CONSIDERATIONS

11. The main issue arising is whether or not the Council is able to enter into negotiations with City Care for new maintenance contracts, rather than going through a contestable process. Given the special relationship that it has with City Care and CCHL, entering into negotiations is an option that is open to the Council to pursue.

The Council's Statutory Obligations

12. The power of general competence contained in s12 of the Local Government Act 2002 enables the Council to carry on or undertake any activity or business, do any act, or enter into any transaction. The Act gives the Council the rights, powers and privileges that it needs to do so. However, the exercise of the Council's powers is subject to the provisions contained in the Act and in any other legislation, and the general law.
13. One of those provisions is section 101(1) of the Local Government Act. It states that the Council must manage its expenses, assets and general financial dealings prudently and in a manner that promotes the current and future interests of its community.
14. Advice provided by the Council's Legal Services Unit and externally by Simpson Grierson is that the Council is able to negotiate new contracts with City Care so long as all of the Council's statutory obligations are satisfied. These include the following decision making processes:
 - (a) Before making its decision to enter into new maintenance contracts, the Council must identify all reasonably practicable options for achieving its objectives and assess those options by considering:
 - (i) the benefits and costs of each, in terms of the present and future social, economic, environmental and cultural wellbeing of the Councils district;
 - (ii) The extent to which community outcomes would be promoted or achieved in an integrated and efficient manner;
 - (iii) The impact of each option on the Council's capacity to meet future and present needs in relation to its statutory responsibility;
 - (iv) Any other matters that in the Council's opinion are relevant.
15. The principal objective in this matter is to ensure that any terms and conditions agreed upon between the Council and City Care represent value for money. They should also be no less favourable than those terms and conditions that the Council would have obtained had it conducted a competitive tender process. This is prudent financial management.
16. In addition to identifying and assessing all reasonably practicable options, the Council must give consideration to the views and preferences of persons and organisations likely to be affected by, or to have an interest in, the decision that the Council ultimately makes. In the present instance, these would include contractors wishing to compete with City Care for the Council's maintenance contracts as well as City Care itself so far as its continued viability is concerned. There is no statutory obligation to use a special consultative procedure.
17. Council staff are aware that there are a number of contractors that would be interested in doing the work currently carried out by City Care. By the time Councillors meet to consider this report, key contractors will have been contacted and provided with a copy of the report. Staff will also have given notice of the meeting to City Care, the Chamber of Commerce and Community Board Members.
18. It is up to the Council to determine how it achieves compliance with the provisions of the Local Government Act 2002. The Council is able to judge for itself:
 - (a) The extent to which different options are to be identified and assessed;
 - (b) The degree to which benefits and costs are to be quantified.

Reasons for Entering into Negotiations with City Care

19. The Council must have regard to s14 of the Local Government Act 2002. This requires the Council to conduct its business in an open, transparent and democratically accountable manner and in accordance with sound business practices. Simpson Grierson advises that often the best way of ensuring compliance with section 14 is to seek competitive tenders in an open market.
20. However, Simpson Grierson also recognises that there may be good reasons for not going to the market. These include:
 - (a) The fact that City Care is a CCTO and a strategic asset;

- (b) By supporting City Care's business the Council is showing prudent stewardship and the efficient and effective use of its resources; and
 - (c) The benefit that the Council derives as a shareholder (through CCHL) of City Care whilst the company establishes itself as a successful competitor in markets other than in Christchurch City. The Council is entitled to take such benefits into account.
21. To ensure that the Council's process is transparent, these reasons are acknowledged and recorded.
 22. The Council will have to make sure that the terms and conditions of any contracts entered into with City Care are consistent with sound business practice. It is recommended that an independent consultant is engaged to chair the panel that will be negotiating with City Care and, at the end of the process, to provide confirmation that the contracts will give value for money.
 23. The consultant should also be able to report that:
 - (a) Any terms and conditions agreed upon by the Council and City Care are similar to those that the Council would have obtained in the market from a competitive tender process
 - (b) The margins incorporated in the prices or rates negotiated are no greater than what City Care would have recovered on a competitively tendered contract.

Significance

24. The Council's policy on determining significance is set out in its 2006-16 LTCCP. The policy includes a list of assets that the Council considers to be strategic assets. These include:
 - (a) The equity that Christchurch City Holdings Limited holds in City Care Limited;
 - (b) The water supply network;
 - (c) The sewerage collection treatment and disposal system;
 - (d) Pump stations and the treatment works; and
 - (e) Reserve lands and lands used for parks, gardens, sports fields, recreational areas and cemeteries.
25. The policy also lists groups of activities that the Council considers to be significant. These include parks, open spaces and waterways, streets and transport, waste water collection and treatment, and water supply. Maintaining the assets provided in respect of each group of activities is not a significant activity.
26. What is significant is the value of the maintenance contracts awarded to City Care. Individually most of them are worth more than \$1 million each year. The total value of the 3 groups of contracts is \$32 million. Whether the Council negotiates new contracts with City Care or adopts a competitive tender process, there is unlikely to be a substantial variation of this sum nor any change in the Council's levels of service for its maintenance work. The cost is already a budgeted item in the LTCCP.
27. The Council's decision therefore will be to determine whether it should either negotiate new contracts with City Care or seek competitive tenders. To this extent, the decision does not have the degree of significance required by the significant policy either in terms of:
 - (a) Its impact on the wellbeing of Christchurch; or
 - (b) The costs to or capacity of the Council to provide for the wellbeing of the City.
28. Consideration has also been given to the possible effect of section 97 of the Act. This requires explicit provision in the LTCCP for a decision to alter significantly the intended level of service for any significant activity undertaken by or on behalf of the Council. The advice on this point is that although the contractor may be different as a result of any decision made by the Council, the intended level of service will not be significantly altered. Therefore, section 97 would not apply.

Conflict of Interest

29. The matter of whether or not a conflict of interest exists in this matter has also been considered. Notwithstanding the fact that the Council is not a shareholder in City Care, the company is nevertheless a CCTO. The Council indirectly controls the shares held by Christchurch City Holdings Limited, which is itself a CCTO. The Council will be considering issues relating to the delivery of services that could affect the financial position of City Care.
30. The office of the Auditor-General has recently looked at conflicts of interest affecting public entities in its report on the policies and practices of the three Auckland District Health Boards. The report notes that the existence of a conflict of interest does not have to cause problems, it just needs to be identified and managed carefully. The Auditor-General's view is that managing a conflict of interest requires careful judgement and involves a balance between the need to reduce risk and the need for an organisation to operate effectively.
31. Council staff intend to manage this issue by the recruitment of independent members of the panel appointed to conduct the negotiations with City Care and the appointment of Simpson Grierson as an external advisor. The panel will also undertake the competitive tender process, if that is required at the end of the negotiation process.

Contractual Obligations

32. The Council sold its "Works Operations" business to Canroad Construction Ltd (later changed to City Care Ltd) on 1 December 1999. The parties entered into arrangements that secured favourable treatment for City Care for up to 5 years from that date.
33. The Council also agreed to be responsible for a proportion of redundancy costs that City Care might incur as a result of a change in its circumstances or to achieve efficiencies in City Care's business. This obligation is determined by the period that an employee's employment with the Council bears to his or her total employment with both the Council and City Care. The cost cannot be calculated until actual redundancy decisions are made.
34. The obligation expires on 1 December 2009. Should any redundancies occur as a result of City Care losing any or all of its maintenance contracts with the Council, the Council will have to contribute to the costs of this.
35. In 2003 the Council agreed to an extension of the term of some of its contracts in return for a reduction of the price paid to City Care. This did not affect the arrangements referred to in paragraph 32. These expired in 2004.

Auditor-General's Guidelines for Procurement

36. The Auditor-General's office has recently issued updated guidelines for the procurement of goods and services by public entities, including local authorities. The Auditor-General clearly intends that organisations such as the Council will comply with the provisions of the Guidelines.
37. The Auditor-General's Office expects a public entity, when selecting the method to be used to engage with the potential suppliers of goods or services, to consider:
 - (a) The need, wherever possible, to promote open and effective competition throughout the procurement process; and
 - (b) The value of, and risk associated with the procurement.
38. The guidelines also state that open tender or proposal processes are used to promote transparency and value for money. It is the view of the Auditor-General's office that these processes are most appropriate for middle to high value procurements where there are a number of potential suppliers in the market. Although closed tender or proposal processes may be appropriate in some circumstances, limited use should be made of this method and when it is, the public entity should document its reasons for doing so. It should also properly justify using a closed tender or proposal method.

39. "Value for Money" is defined in the guidelines as meaning:

"The use of resources effectively, economically and without waste, with due regard for the total costs and benefits of an arrangement and its contribution to the outcomes the entity is trying to achieve.

The principle of value for money when procuring goods or services does not necessarily mean selecting the lowest price but rather the best possible outcome for the total costs of ownership (or whole-of-life cost).

Value for money is achieved by selecting the most appropriate procurement method for the risk and value of the procurement, and not necessarily by using a competitive tender".

40. The Council's objective is to obtain value for money in respect of its maintenance contracts. Council staff are of the view that given the nature of the relationship with City Care, it is appropriate for the Council to enter into negotiations with that company, provided that due regard is given to the total costs and benefits that would accrue and the best possible outcome is achieved.
41. Council staff recommend that the Council enters into negotiations with City Care before a decision is made whether or not to award contracts to City Care or to conduct an open tender process

ALIGNMENT WITH STRATEGIES

42. The proposal that the Council enter into negotiations with City Care is not in breach of any policy or strategy for the procurement of goods and services by the Council.

CONSULTATION FULFILMENT

43. There is no statutory obligation imposed on the Council to consult before it makes a decision in this matter. However, Council staff have obtained advice from a number of sources.
44. Internally, the Legal Services Unit has provided advice on process issues from time to time. A group comprising the managers of the water and waste, greenspace, corporate support and procurement units has met regularly for over a year for the purpose of considering and evaluating the available options for dealing with the maintenance contracts. There have been regular reports to the executive team.
45. Externally, there have been discussions with the Chief Executive of Christchurch City Holdings Limited, who provided information relating to the financial implications should City Care not be awarded the maintenance contracts. A local company, Spire Consulting Limited, has provided advice on issues around assets and facilities management, including identifying and assessing the options available to the Council.
46. The Council's external strategic legal advisor, Simpson Grierson, has been retained to provide advice to Council staff in respect of the process to be adopted once the Council makes its decision. The firm has been involved in a number of situations where local authorities have awarded contracts to CCTOs without going through a competitive tender process.
47. The equity that is held on behalf of the Council in City Care is a strategic asset. However, for the reasons already stated, the special consultative procedure is not required before the Council can make a decision to negotiate new maintenance contracts with the company. If a decision was made to conduct a competitive tender process for the contracts, an issue may arise with regard to consultation if the contracts were awarded to another organisation.

STAFF RECOMMENDATION

It is recommended that the Council resolves that it:

- (a) Authorises the Chief Executive to appoint a panel comprising internal and external members and chaired by an external consultant to enter into negotiations with City Care Limited for new maintenance contracts, to replace those referred to in the **Schedule attached to the public excluded report**.

- (b) Authorises the Chief Executive, after receiving the panel recommendations to either:
 - i) enter into new maintenance contracts with City Care.
 - or
 - ii) instigate a competitive tender process for new maintenance contracts.
- (c) Note that if the Chief executive's view is different from the panel's view, he will report to Council prior to making any decision.

BACKGROUND (THE ISSUES)

- 48. In 1999 the Christchurch City Council sold its Works Operations and Plant and Building Services businesses to Canroad Construction Limited which subsequently changed its name to City Care Limited.
- 49. The company was a Local Authority Trading Enterprise established by the Council under the Local Government Act 1974. The shares were initially held by the Council but in 2002 they were transferred to Christchurch City Holdings Limited. City Care became a CCTO when the Local Government Act 2002 came into effect in July 2003.
- 50. City Care's Statement of Intent for the year ending 30 June 2009 states that one of its objectives is to continue to compete in Christchurch markets and to aggressively target a significant share of work offered for tender by Christchurch City Council. Another is to operate the Company's business in a way that generates appropriate financial returns and dividend streams for its shareholder. The forecast dividend for 2008-09 is \$1.646m.
- 51. A majority, but not all, of the maintenance work previously undertaken by the Council was awarded to City Care.
- 52. The form of the contracts originally entered into with City Care need to be updated to reflect the requirements of both parties. They have been varied a number of times and expiry dates have been extended. However, it is appropriate that new contracts are negotiated, either with City Care or with any other contractor that successfully tenders for the work.
- 53. The contracts due to expire and which are the subject of this report are set out in the schedule attached to the report to be considered with the public excluded.
- 54. The decision to be made by the Council is whether or not to enter into negotiations with City Care for new maintenance contracts or to open them up for tender by way of a competitive process. In the normal course of events, the competitive tender process would be the most appropriate way to deal with the matter.
- 55. In this case, the fact that City Care is CCTO and the Council's interest in the organisation is a strategic asset means that there are other considerations to be taken into account.
- 56. City Care no longer exists purely to carry out work under contract to the Christchurch City Council. Its website states that City Care provides "construction, maintenance and management services across New Zealand's amenity assets and infrastructure including parks, water ways, roads, buildings and underground networks". The company has annual revenue of \$115 million and employs in excess of nine hundred full time equivalent staff.
- 57. The website also states that City Care has operational bases in Auckland, Tauranga, New Plymouth, Hawera, Western Bay of Plenty, Christchurch, Timaru and Dunedin. Services are provided to local and central government and other major owners of infrastructure such as educational institutions, private companies and other contracting organisations. City Care has recently been awarded maintenance contracts by Rodney District Council, Manukau Water and Wellington City Council.

58. It is apparent therefore that City Care is actively expanding its business. The Council could support this by looking to maintain City Care's current base whilst the company pursues other opportunities. Such a move could be seen as prudent stewardship and the efficient and effective use of the Council's resources. The benefits of a strong, financially sound organisation which is also a strategic asset, is one of the matters that the Council is entitled to take into account when considering whether or not to enter into negotiations with City Care, or to seek competitive tenders.
59. As indicated earlier, the Council also has an obligation to undertake any commercial transactions in accordance with sound business practices. It is recommended that a panel containing external consultants be appointed to enter into negotiations with City Care and at the end of the process to provide independent confirmation that the contracts negotiated represent value for money.
60. The panel should also aim to achieve:
- (a) Agreed terms and conditions similar to what the Council would have obtained in the market from a competitive tender process;
 - (b) Margins incorporated in the prices or rates agreed with City Care that are similar to what that organisation would recover on a competitively tendered contract.
61. As well as complying with the relevant provisions in the Local Government Act 2002, the Council is required to have regard to its own procurement policies and strategies. If a decision to negotiate only with City Care was inconsistent with these, then under section 80 of the Act the Council would have to identify any inconsistency and the reasons for it and then indicate its intention to amend the policy or strategy to accommodate the Council's decision.
62. The Council has a policy in respect of the competitive tendering of Council services. It states that all Christchurch City Council services where possible should be tested against those provided by the private sector and contracted out where appropriate. Although it is a CCTO, City Care is not an "in-house" provider. If negotiations with City Care fail to produce a satisfactory outcome, it would be appropriate to then go to an open tender process.
63. The Council also has a policy of preferring local firms. Negotiating with City Care would not be inconsistent with that policy.
64. In June 2008 the Auditor-General's Office issued new guidelines for the procurement of goods and services by public entities. A "public entity" includes a local authority.
65. This document sets out the Auditor-General's view of the good practice that public entities should adopt to procure goods or services. It outlines expectations that the Auditor-General may use when carrying out performance audits or enquiries. The principles on which the guidelines are based should be considered when a public entity is considering any funding arrangement with an external party, including procuring goods or services.
66. The principles are summarised as follows:
- (a) Accountability. Public entities should be accountable for their performance.
 - (b) Openness. They should be transparent in their administration of funds.
 - (c) Value for money. Public entities should use resources effectively, economically and without waste. The principle of value for money for procuring goods or services does not necessarily mean selecting the lowest price, but rather the best possible outcome for the total cost of ownership.
 - (d) Public entities must act within the law, and meet their legal obligations.
 - (e) Fairness. Public entities have a general public law obligation to act fairly and reasonably. They must be, and must be seen to be, impartial in their decision making.
 - (f) Integrity. Anyone who is managing public resources must do so with the utmost integrity.

67. The Council's procurement unit has looked closely at the Auditor General's guidelines and is satisfied that provided the appropriate steps are taken to ensure that in particular the principle of getting value for money is met then a decision to negotiate new maintenance contracts with City Care can be managed in accordance with those guidelines.
68. An important point to remember is that a decision to enter into negotiations with City Care will not mean that the Council is bound to complete contracts with that organisation. The Council will be free to undertake a competitive tender process if it cannot be satisfied that the terms and conditions agreed to with City Care give value for money.

THE OPTIONS

ASSESSMENT OF THE MOST PRACTICABLE OPTIONS

Option 1 - Bringing Maintenance back In-house:

- (a) A significant investment of capital and other resources would be required to set up a new unit within the Council structure;
- (b) There would be a reduction in the level of dividends derived from City Care, at least in the short term;
- (c) Lack of support from its own Council could reflect badly on City Care;
- (d) The Council has a contractual obligation to contribute to the costs of redundancies resulting from a change in City Care's circumstances;
- (e) Further detailed assessment of the costs and benefits of this option would be necessary to determine whether or not it would achieve the Council's objective of value for money;
- (f) There is a risk that the Council would not be able to fully resource its maintenance requirements in what currently is a tight labour market;
- (g) This work is not a core focus for Council;
- (h) Key staff would be diverted back to managing structural change rather than the delivery of services;
- (i) It is possible that the best operational and financial model would be the establishment of a new CCTO. This may merely duplicate the current situation, although with a focus only on the maintenance of Council assets.

Option 2 - Entering into negotiations with City Care:

- (a) The organisation is a CCTO;
- (b) The Council's equity in City Care is a strategic asset;
- (c) The Council would be supporting City Care's business whilst it expanded into other areas;
- (d) A strong dividend stream contributes to the financial strength of the Council group;
- (e) Possible redundancies would be avoided;
- (f) The Council would be supporting its community;
- (g) City Care's proven civil defence and fire fighting capability. This is enhanced by one contractor holding long term contracts with the Council;
- (h) The Council would have the ability to take over all City Care resources in the event of a civil defence emergency;
- (i) Provided that negotiated contracts give value for money there should be no impact on the Council's statutory responsibilities;

- (j) Disaffected contractors could challenge the Council's decision to negotiate only with City Care;
- (k) If suitable terms and conditions can't be negotiated, then the Council still has the option of going to the market.

Option 3 Adopting a competitive tender process:

- (a) Could be the best way to ensure compliance with the Council's statutory responsibilities;
- (b) May result in the Council obtaining the best contractual terms and conditions;
- (c) The successful tenderer may not be based in Christchurch or in New Zealand. This may have an adverse effect on the local economy;
- (d) Redundancies would be inevitable if City Care was to lose any or all of the maintenance contracts it currently holds;
- (e) The Council has a contractual obligation to contribute to the costs of redundancies resulting from a change in City Care's circumstances;
- (f) The emergence of a substantial Canterbury-based contractor may provide a boost to the local economy;
- (g) City Care is strong enough to continue developing its business despite the potential loss of Council contracts;
- (h) There would be a reduction in the level of dividends derived from City Care, at least in the short term;
- (i) The Council would be criticised for not supporting a local based business;
- (j) Lack of support from its own Council could reflect badly on City Care.

Option 1

- 69. The first option is not recommended, mainly because it would involve a significant investment of capital and staff resources. It would also have an adverse effect on City Care's business.

Option 2

- 70. The second option is to undertake a competitive tender process in respect of the contracts in the schedule. It is acknowledged that in the normal course of events this would be the most appropriate method of dealing with the matter. However, it is the advice of Council staff that the Council is entitled to take into account the fact that City Care is a CCTO and a strategic asset. For the reasons set out in this report, Option 2 is not recommended.

Option 3

- 71. The third option is for the Council to decide to enter into negotiations with City Care for new maintenance contracts. Dealt with properly this option will comply with the provisions of the Local Government Act 2002 and the Auditor General's guidelines. It acknowledges that City Care is a CCTO and a strategic asset. The advice from Council staff is that provided the appropriate steps are taken to ensure that any recommendation following the negotiation process is independently verified as being in accordance with sound business practice then it is open to the Council to adopt this option.
- 72. It is important to note that any decision to enter into negotiations with City Care will not bind the Council to contractual arrangements with that organisation. If the recommendations of staff are adopted, then it is open to the chief executive to undertake a competitive tender process once the outcome of negotiations with City Care are known.

PREFERRED OPTION

- 73. The preferred option is option 3.