
TRANSFORMING REHABILITATION : A STRATEGY FOR REFORM

**Responsible Cabinet Member - Councillor Bill Dixon,
Leader and all Cabinet Members**

Responsible Director - Murray Rose, Director of Commissioning

SUMMARY REPORT

Purpose of the Report

1. To update Members' on the position in respect of the local bid to deliver offender management services via Achieving Real Change in the Community CIC Limited (ARCC), a Community Interest Company.

Summary

2. Previous reports on the Government's "Transforming Rehabilitation" programme (October 2013, May 2014) outlined Government's intention to abolish the system of 35 local Probation Trusts across England and Wales, replacing them with a single National Probation Service (NPS) and 21 Community Rehabilitation Companies (CRC) dealing with offenders assessed as a "medium" and "low" risk. Bids to run CRCs were invited in which share holdings were to be sold to interested bidders with the emphasis being on bidders from the private and voluntary sectors.
3. The Council supported the development of a consortium of partners, forming a Community Interest Company (CIC), Achieving Real Change for Communities (ARCC). The consortium builds on the work of the former Durham Tees Valley Probation Trust, one the best performing Probation Trusts, in the top 10% for results and the lowest 25% for costs.
4. ARCC is a CIC without shareholdings supported by:
 - (a) Changing Lives BE CIC
 - (b) Darlington Borough Council
 - (c) Redcar and Cleveland Borough Council
 - (d) Safe in Tees Valley
 - (e) Stockton on Tees Borough Council
 - (f) Tees, Esk and Wear Valley NHS Mental Health Trust
 - (g) The Thirteen Group
 - (h) The Vardy Foundation

(i) The Wise Group

5. On 29 October 2014, the Ministry of Justice (MoJ) notified ARCC it had been selected as the preferred bidder for Durham Tees Valley Contract. The notification of preferred bidder selection is a major step in the procurement process; however, selection is conditional on all outstanding issues being resolved, contract documentation being satisfactorily agreed and on the MoJ obtaining all necessary approvals to make an award decision. Agreements in respect of the contracts are to be signed in December 2014 with the new arrangements to “go live” from 1 February 2015.
6. Previous reports to Cabinet (1 October 2013, 1 April 2014) put in place approval for the Council to participate in the tendering process and for a loan from Council reserves (£1m) to be earmarked for ARCC should it be successfully awarded the contract. The loan of £1m from the Council is proposed to enable ARCC and the CRC Company to cash flow operations. The loan will be repayable over the contract term with the total outstanding sum repayable on demand in event of default. Interest will be charged at commercial rates that will not lead to a state aid arising. A loan agreement will be put into place between the Council and the CRC Company in respect of the loan to be provided by the Council at commercial rates.
7. This report deals with the financial and legal implications of the Council’s participation in the partnership. These relate to :-
 - (a) a Deed of Guarantee required by the MoJ; and
 - (b) the release of the loan of £1m.
8. Upon being notified that it has preferred bidder status, a process of due diligence, including an independent external assessment of the financial viability of the bid and the risks attached to it is underway and will inform the final delegated decision to enter into a contract with the MoJ.
9. The Deed of Guarantee to the MoJ is to reimburse it in the event of significant failures in performance, including a failure so complete that it would require a re-commissioning process. The MoJ set a value of Guarantee for Durham Tees Valley of approximately £14.12 million. The guarantee will be irrevocable and stand for the contract term, seven to ten years.
10. Discussions within the consortium established that Stockton Borough Council is the partner best placed to stand as Guarantor for the bid; but also that the potential risk, and the contingent liability on accounts should be shared among consortium partners. The way to achieve this is by subsidiary guarantee provided by other partners.
11. The guarantee and lending is split among the Board members of ARCC on the following basis:

Table A

	Percentage financial contribution	Guarantee
(a) Darlington Borough Council	17.34	2.45M
(b) Redcar and Cleveland Borough Council	17.34	2.45M
(c) Stockton on Tees Borough Council	34.68	4.90M
(d) The Thirteen Group	17.34	2.45M
(e) The Vardy Foundation	10	1.41M
(f) The Wise Group	3.3	0.47M
(g) Safe in Tees Valley	0	0
(h) Changing Lives BE CIC	0	0
(i) Tees, Esk and Wear Valley NHS Mental Health Trust	0	0

12. In the unlikely event of failure by the private guarantors to meet the guarantee obligations, the public sector guarantors will be expected to share this liability. However the likelihood of default of any or all of the private guarantors is extremely low.
13. The only exception to the above would be for losses arising in respect of death or personal injury. Such risk is very low and the governance arrangements proposed ensure that the Council can ensure all risks to be adequately covered by insurance, and if appropriate sufficiency of reserves.
14. Without a Guarantee, the ARCC bid will be disqualified and the Community Rehabilitation Company contract would realistically be under the control of a commercially driven organisation.

Recommendation

15. It is recommended that Cabinet:-
- (a) Endorse the action taken to date and;
 - (b) Note the variation to the voting structure of ARCC with the effect that the Council has voting rights commensurate with its financial contribution and risk;
 - (c) Agree a delegation to The Director of Neighbourhood Services and Resources to appoint a member of the board of ARCC to exercise the voting rights of Darlington Borough Council;
 - (d) Note the proposed delegation to the Director of Neighbourhood Services and Resources to validate the content of the State Aid Assessment and to ensure the guarantee is in accordance with its requirements
 - (e) Note the proposed delegation to the Director of Neighbourhood Services and Resources to be satisfied that the independent financial assessment substantially validates the business model as set out in Appendix 2;

And subject to (c) and (d)

- (f) Agree, subject to Council approval to make a guarantee against reserves, that Council provide Stockton Borough Council a subsidiary guarantee of £2.45m to £3.53m alongside other partners in the bid ;
- (g) Agree a contract be entered into by the Council with the CRC company for repayment of the assessed market value of the guarantee;
- (h) Agree subject to Council approval to release the £1m of reserves, that Council put in place £1m loan to ARCC at commercial lending rates;
- (i) Agree a delegation to the Director of Neighbourhood Services and Resources in consultation with the Leader of the Council, The Director of Commissioning and the Assistant Chief Executive to finalise the subsidiary guarantee and loan agreement and ancillary documents.

Reasons

16. The recommendations are supported by the following reasons :-

- (a) To put in place approvals for required actions to progress the bid to tender, and
- (b) To enable the Council to further participate in the due diligence activities to ensure risk is clearly understood and minimised.

Murray Rose
Director of Commissioning

Miriam Davidson, Director of Public Health : Extension: 2463

S17 Crime and Disorder	The report details the intention for the Council to become involved with consortium partners in the delivery of offender management and rehabilitation services. The local bid is to maintain, then improve the strong record in reducing re-offending.
Health and Well Being	The successful delivery of probation services will have a significant impact on health and well being
Carbon Impact	There are no carbon impact implications in this report
Diversity	The Council has a duty to protect residents affected by crime and disorder.
Wards Affected	All Wards will be affected by this change in provision.
Groups Affected	Probation Service users and wider community
Budget and Policy Framework	Specific approvals will be sought from Council in respect of the (i) Guarantee (ii) Loan (this latter will be given based on prudent investment assumptions)
Key Decision	The change in provision affects all communities in the Borough.
Urgent Decision	Partners were notified by the MoJ (Ministry of Justice) that ARCC was the preferred bidder on 29 October 2014 with subsequent information "drops" from the MoJ throughout early November, 2014.
One Darlington: Perfectly Placed	This report contributes to the theme "Safer Darlington" and building strong communities.
Efficiency	There are no specific impacts on efficiency resulting from this report.

MAIN REPORT

Information and Analysis

17. Previous reports on the Government's "Transforming Rehabilitation" programme (October 2013, May 2014) outlined Government's intention to abolish the system of 35 local Probation Trusts across England and Wales, replacing them with a single National Probation Service (NPS) and 21 Community Rehabilitation Companies (CRC) dealing with offenders assessed as a "medium" and "low" risk. Bids to run CRCs were invited in which share holdings were to be sold to interested bidders with the emphasis being on bidders from the private and voluntary sectors.

18. The Council supported the development of a consortium of partners, forming a Community Interest Company (CIC), Achieving Real Change for Communities

(ARCC). The consortium builds on the work of the former Durham Tees Valley Probation Trust, one of the best performing Probation Trusts, in the top 10% for results and the lowest 25% for costs.

19. ARCC is a CIC without shareholdings supported by:
- (a) Changing Lives BE CIC
 - (b) Darlington Borough Council
 - (c) Redcar and Cleveland Borough Council
 - (d) Safe in Tees Valley
 - (e) Stockton on Tees Borough Council
 - (f) Tees, Esk & Wear Valley NHS Mental Health Trust
 - (g) The Thirteen Group
 - (h) The Vardy Foundation
 - (i) The Wise Group
20. The consortium submitted its bid in June, received feedback in August and alongside other bidders, re-submitted in September. The ARCC bid was assessed as one of the stronger bids and at the end of October 2014, partners were notified by the MoJ that ARCC had been selected as the preferred bidder (see **Appendix 1**).
21. A process of due diligence, including an independent external assessment of the financial viability of the bid and risks attached to it is underway. One of the requirements of the process is for every bidding organisation to provide a Deed of Guarantee to the MoJ to potentially reimburse the MoJ for significant failures in performance, including an eventuality where a re-commissioning process is required.
22. The MoJ set a value of Guarantee for Durham Tees Valley CRC (the CRC Company) of approximately £14.12 million. Discussions within the consortium established that Stockton Borough Council was best placed to stand as Guarantor for the bid but also that the contingent liability on accounts should be shared among partners.
23. Without such a Guarantee, the ARCC bid would be disqualified and the CRC would probably be under the control of a commercially driven organisation. In mitigation of risk the contract would be for at least seven years; with options to extend to 10 years and that ARCC's status as a CIC without shareholding provides an opportunity for surpluses generated to be reinvested within Durham Tees Valley enterprise.
24. The notification of preferred bidders at the end of October 2014 marks the start of a "Mobilisation" period – i.e. from end of October until 1 February 2015. "Transition" commences from 1 February 2015 for three months, to 1 May 2015. Award decisions will be made by the MoJ following satisfactory conclusion of the preferred bidder period. At the point at which the MoJ notify bidders of award decisions, a ten day 'standstill' period will be in place before any contracts will be agreed.

Financial Implications

25. Subject as below, the guaranteed sum of approximately £14.12 million would be reduced to approximately £2.45 million in terms of the maximum liability of Darlington Borough Council by virtue of the subsidiary guarantees to be provided to the Council by other partners in the consortium.
26. In the unlikely event of failure by the private guarantors to meet the guarantee obligations, the public sector guarantors will be expected to share this liability in proportion with their respective commitments. This takes the maximum liability to £3.53m however the likelihood of default of any or all of the private guarantors is extremely low. Such risk is to be mitigated by the proposed governance arrangements to positively ensure that these risks are suitably insured against by the company delivering the contract.
27. The only exception taking liability outside of the sums stated in paragraph 20 and 21 above is for losses arising in respect of death or personal injury caused by the negligence of the Council/ Contractor since the Council undertakes to ensure the performance of the Company is in accordance with the contract. Such risk is very low and the governance arrangements proposed ensure that the Council can ensure all risks to be adequately covered by insurance, and if appropriate sufficiency of reserves. Such risk is very low and is covered by the Council's insurance arrangements.
28. The guarantee and lending is split among the Board members of ARCC on the following basis:

Table A

	Percentage financial contribution	Guarantee
(a) Darlington Borough Council	17.34	2.45M
(b) Redcar and Cleveland Borough Council	17.34	2.45M
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29. The bid is based on prudent assumptions, the model has been assessed by senior officers from partner organisations (as summarised by ARCC – see **Appendix 2**) and arrangements have been made for a fully independent assessment of the bid, which is now underway,

Legal Implications

30. The Council's membership of the consortium and the issue of the loan and guarantee are covered by its general power of competence under the Localism Act 2011.
31. Contractual matters/ Legal Structure
32. To summarise, and subject to ARCC continuing as preferred bidder the following contractual arrangements are expected to be in place, shown below by agreement type and participant
 - (a) Contract for sale of shares in CRC Company – (1) MoJ to (2) ARCC
 - (b) Services Contract (1) CC Company to (2) MOJ (and (3) Guarantor Stockton Borough Council)
 - (c) Guarantee £14.12m (1) Stockton Borough Council to (2) MOJ in respect of all losses arising to the CRC Company and MoJ
 - (d) Back to back Guarantee (1) Darlington Borough Council, (2) Redcar and Cleveland Council, (3) The Thirteen Group, (4) The Vardy Foundation, and (5) The Wise Group to (6) Stockton Borough Council to back the guarantee at (c) above
 - (e) Contract SBC (and other guarantors) to CRC Company setting out the terms of the provision of the Guarantee Facility (subject to financial state aid assessment) and obligation of the CIC to Stockton (and other guarantors) in respect of the guaranteed matters.
 - (f) Loan Agreements various lenders to the CRC Company. In the case of the Council loan the interest rates to be at specified levels which do not incur a state aid.
33. The MoJ have created a company vehicle, Durham Tees Valley Rehabilitation Company Limited (the CRC Company) which will continue to exist and run the services under the contract to enable continuity over this and subsequent commissioning over which it will continue to retain a share.
34. To enable ARCC, if finally successful, to run the CRC Company ARCC would be required to enter into a share purchase agreement to purchase the majority of the shareholdings in the CRC Company, of which it will be the parent company.
35. Subject to restricted matters reserved to the MoJ (to preserve the integrity of the CRC Company vehicle) the CRC Company would be governed in accordance with the governance structure of ARCC.
36. At present ARCC's company governance is composed of a two tier structure of members, and directors.
37. The directors and officers conduct the day to day affairs while the members have voting rights similar to shareholders rights to a company with shareholdings.
38. The Council has a fiduciary responsibility over the funds loaned and made the subject to the guarantee and should have in place suitable safeguards over those

funds and accordingly in order to enable the Council to exercise due control over fundamental matters and to enable it to influence the adoption in due course of financial, accounting, auditing, legal, and HR policies.

39. Currently the Council has 1/9 votes at member level; it is proposed that the entering into the guarantee be subject that Council voting rights at member level be enhanced proportionate to contribution to the guarantee to provide the Local Authority guarantors sufficient voting influence to meet the obligations of the guarantee and the undertaking to MoJ to ensure that all aspects of contract are delivered and that the same provision be made in respect of the other financial contributors. (see Table A).
40. Collectively the Local Authority Guarantors would then exercise majority voting rights on significant matters of risk and governance relating to the ARCC and CRC Company affairs.

State Aid/ Guarantee and Loan

41. Stockton Borough Council will provide the main guarantee to MOJ in the sum of £14.12m. A copy of that guarantee is at **Appendix 3**.
42. It is proposed, that to facilitate the CRC Company and ARCC continuing with the bid that the guarantee will be backed on like terms by the subsidiary guarantees from the other guarantors to Stockton in the proportions set out in Table A.
43. The loan of £1m from the Council is proposed to enable ARCC and the CRC Company to cash flow operations. The loan will be repayable over the contract term with the total outstanding sum repayable on demand in event of default. Interest will be charged at commercial rates that will not lead to a state aid arising. A loan agreement will be put into place between the Council and the CRC Company in respect of the loan to be provided by the Council at commercial rates.
44. Using the Council's resources to provide assistance, including the giving of guarantees in a way that gives advantage over others may amount to state aid. The European Commission has produced specific guidance in respect of the provision of guarantees and gives criteria under which guarantees may be given compliantly with the rules, similar provisions apply in respect of lending.
45. To remove the State Aid implication the market value of the guarantee facility need to be paid by the recipient to the Council.
46. The guarantee will also be subject to a state aid assessment. The CRC Company will be required to enter into an agreement with Stockton and via SBC the other guarantors to the effect that the assessed commercial value for the facility will be paid to the public body guarantors in shares commensurate with their contribution.
47. There is a *de minimis* amount of State Aid which is acknowledged as acceptable under state aid principles of 200,000 Euro over a three year period.

48. Subject to a declaration from the CRC Company that it is not in receipt of any other state aid, which would use up this allowance, the sum to be paid for the guarantee may be reduced by the State Aid *de minimis* sum.
49. The commercial value of the Guarantee facility is the subject of a formal financial assessment being conducted by Deloitte acting on behalf of the three Local Authority lenders/ guarantors. It is anticipated that the proposed changes to the ARCC company voting structure will reduce the commercial value of the facility, thus assisting the CRC Company operation, enabling surplus funds to be put into rehabilitation and prevention of offending strategies while enabling the Local Authority Guarantors to have a degree of oversight of the ARCC and CRC Company commensurate with financial risk.
50. Risk and Governance -

Table B

Risk Description	Mitigation
i. ARCC operating model not meeting contract requirements	The ARCC bid is modelled on historic levels of performance on the part of the Durham Tees Probation Trust and is based on prudent financial assumptions.
ii. Reduction in members of offenders coming through the system impacts on workforce and associated costs.	Mobilisation plan and transition plan include monitoring and early alert of performance metrics.
iii. NAPO is seeking judicial review of the MoJ procurement process, could lead to delay	MoJ advises this is possible but low risk.
iv. Stakeholders unaware of the model of delivery or failure to deal with interested partners	Communication strategy in place, face to face meetings available with ARCC CEO and Board Chair.
v. Risk of Guarantee being invoked by the MoJ to reimburse it for significant failures in performance up to and including catastrophic failure requiring a re-commissioning process.	The overall guaranteed sum circa £14.12m will be reduced to £2.45m in terms of the maximum liability to the Council, because of the subsidiary guarantees to be provided by other partners. Governance arrangements to be in place to mitigate the risk. Organisations investing public money, i.e. the three Local Authority partners to have voting rights commensurate with investment risk. The governance acts as a control to prevent the Call on Guarantee, to ensure contract compliance and insurance, and if appropriate suitable reserves and to limit loss

51. See above as a condition of giving the guarantee the Council will require the voting rights attributable to it to be commensurate with financial contribution and risk.
52. A short form contract will be put in place to deal with the obligations of the delivery company and the conduct of the consortium parties (to include payment of the market rate for the guarantee, delivery of services with due skill and care, minimum insurance requirements).

53. A financial assessment is being conducted by Deloitte on behalf of the three local authorities. In addition to the State Aid this includes an assessment of the financial business model.

Delivery Contract and Share Purchase Agreement

54. The above have been reviewed and due diligence and advice provided to the consortium by the Endeavour Partnership LLP. The advice has been made available to Council officers and that is to accept the contract terms without significant further amendment.

Delegations

55. It is proposed that Cabinet agree a delegation to the Director of Neighbourhood Services and Resources to appoint an appropriately qualified officer as member of the board of ARCC to exercise the voting rights of Darlington Borough Council and oversee and protect its interests as far as the voting rights enable it to do so, and to highlight and return to Cabinet on any issues (not covered in this report) relating to ARCC or the CRC Company likely to impact on the interests of Darlington Borough Council.

HR Implications

56. The proposed delivery model for the Community Rehabilitation Company includes staffing structures and workforce plans, however this does not impact on the Council's current workforce.

Procurement Advice

57. There are no procurement implications involved in the giving of the guarantee or the loan.
58. The CRC Company is likely to be subject to procurement rules and a contract is proposed to be put into place between the board members (providing financial support) and the CRC Company that the services it delivers be carried out with due skill and care.

Equalities Considerations

59. No specific need for equalities consultation has been identified as the service provision is not intended to change. However the level of public sector influence in the delivery company should ensure that where any service changes or other matter is proposed which would require equalities consultation that such consultation will be effected in the future as and when appropriate for the benefit of service users and other affected individuals.

Consultation

60. No specific need for consultation has been identified as the service provision is not intended to change. However the level of public sector control in the delivery company will ensure that where any service changes or other matter is proposed which would require equalities consultation that such consultation will be effected in the future as and when appropriate for the benefit of service users and other affected individuals.
61. MoJ have led a communication and market development process. They linked to the bidder, events in each of the CRC localities.

Risk Assessment

62. See **Table B**: the risks involved with the proposals are considered low subject to the adoption of the new governance arrangements.