

Transport and Environment Committee

10.00am, Thursday, 19 August 2021

Reform of Transport Arm's Length External Organisations

Executive/routine Wards Council Commitments	Executive All 21
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1. Recommendations

- 1.1 It is recommended that Transport and Environment Committee:
 - 1.1.1 Note the considerations of the short life working group, including the options for reform;
 - 1.1.2 Agree to progress with the reforms to the Transport Arms Length External Organisation (ALEO) structure, as set out in paragraphs 4.20 – 4.25; and
 - 1.1.3 Request updates as implementation moves forward.

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Report

Reform of Transport Arm's Length External Organisations

2. Executive Summary

- 2.1 This report provides an update on progress with the proposed reform of the Council's Transport Arm's Length External Organisations (ALEOs). It includes details of the conclusions of the short life working group and engagement with key stakeholders. The report sets out a preferred way forward with on-going engagement with key stakeholders. No changes in the transport services or branding of existing Council owned public transport companies will take place as a result of these proposals, which are designed to achieve a truly multi-modal approach.

3. Background

- 3.1 City of Edinburgh Council has three Transport ALEOs: Transport for Edinburgh Limited, Lothian Buses Limited and Edinburgh Trams Limited. City of Edinburgh Council is the sole (100%) shareholder of Transport for Edinburgh. Transport for Edinburgh holds the Council's shareholding for Lothian Buses (91%) and Edinburgh Trams (100%). East Lothian, Midlothian and West Lothian Councils also hold a minority shareholding in Lothian Buses.
- 3.2 A report to Policy and Sustainability Committee dated [9 July 2020](#) set out the current arrangements for the management of the Council's Transport ALEO's and highlighted challenges in continuing to manage existing arrangements. It set out objectives for future public transport provision and proposed consultation with the public transport companies, the recognised trade union and minority shareholders to seek their views on the structure of the public transport companies.
- 3.3 The report made clear that greater integration of the public transport companies should achieve both required improvements in transport and mobility operations and outcomes, as well as efficiencies which could be reinvested in the business.
- 3.4 A further report to Transport and Environment Committee on [12 November 2020](#) set out the outcome of the initial appraisal of the options for Transport ALEO reform. This showed that there was support for reform but that further development of the Council's preferred option (creation of a single company) and refinement of another

option (adaptation of the existing model) was required. Committee agreed that a short life working group should be established to take this forward.

- 3.5 The working group, comprising Council officers and Non-Executive Director (NED) representatives from each of the Transport ALEOs, met for the first time in early December 2020. The group met five times in total.
- 3.6 While the working group has progressed with the tasks set out, engagement with Unite and the employee representative (of Lothian Buses) has continued in parallel.
- 3.7 In addition to the working group, a legal sub-group was convened to explore possible legal constraints on delivery of Transport ALEO reform. While the legal sub-group did not consider the preferred structure, legal advice has been received by the Council which states that there are not any legal barriers envisaged to delivery of the preferred structure.

4. Main report

Strategic Context

- 4.1 The short life working group agreed a series of guiding principles (attached as Appendix 1) to guide the conduct and output of the working group along with a set of transition principles (attached as Appendix 2), which built on the objectives agreed by committee in November 2020 and set out the requirements of the end state organisational model.
- 4.2 These principles acknowledge the challenges faced by the existing structure but importantly also demonstrate the ambition of the short life working group to develop a structure which supports integration of transport across modes, is able to respond to new opportunities as they arise and is able to support mobility across the city and region.
- 4.3 The working group also considered that the commercial sustainability of any new arrangement was also key, particularly given the likely recovery period for public transport in the wake of the Coronavirus (COVID-19) pandemic. In this context, efficiency savings as a result of reform become particularly important and a strategic approach to efficiencies across all companies should be enabled.
- 4.4 The recently adopted City Mobility Plan (CMP) outlines policy measures designed to support delivery of the vision and objectives. Of most relevance to ALEO reform is the need to reform the governance of the public transport companies in order to deliver strong integration between modes and to deliver public transport which takes account of public policy drivers. This policy measure seeks opportunities for greater integration in areas like pricing and ticketing, integrated routing and the creation of a better public transport experience. It notes that better alignment of strategic business planning and operational management of the Council-owned transport companies with the city's transport policies and programmes needs to be accelerated if the foundation for transformational change is to be laid securely.

- 4.5 The policy of governance reform itself supports optimal delivery of other policy measures within the CMP, including the requirement to explore further expansion of the rapid transit system, a bus network review, development of city interchanges, delivery of integrated ticketing and fleet enhancement. The CMP also notes the regional dimension of public transport provision. It notes that strengthening cross local authority border public transport services will be key to tackling the environmental and economic impacts of significant in-commuting into Edinburgh and, in light of the cross regional ownership of Lothian Buses, reform of governance of the public transport companies is well placed to maximise opportunities to develop this.
- 4.6 It is important to underline that in delivering Council policy, engagement is required not only with the Council's transport ALEOs, but also with other public transport providers in the city.

Working Group Conclusion

- 4.7 In considering the proposed approach to governance of the Council's transport ALEOs moving forward, the working group agreed that the travelling public should not be impacted negatively in any way by the emerging proposals.
- 4.8 They considered three corporate structures. Broadly, those were:
- 4.8.1 One single transport company for all modes;
 - 4.8.2 A 'parent' company responsible for strategic decision making, but with subsidiary operational company or companies; and
 - 4.8.3 A refresh of the existing three entity structure with new corporate documentation and shareholder agreements.
- 4.9 In addition to the objectives set out for the new structure, consideration was also given to mitigation of risks associated with transition. Principal risks were considered to be:
- 4.9.1 TUPE and industrial relations;
 - 4.9.2 The challenge of embedding a new culture; and
 - 4.9.3 Disruption during recovery from the COVID 19 pandemic.
- 4.10 In analysing the three corporate structures, the working group considered that:
- 4.10.1 While the single company option had been the preferred option of the Council, it was a less attractive option as it significantly increased the industrial relations risk and did not deliver benefits that could not be achieved through the other options. This is because it would inevitably involve significant TUPE transfer of staff (which is a potentially major disruptive factor) and the working group felt the benefits of reform could be secured without this having to take place; and
 - 4.10.2 Utilising the existing structure, retaining three companies with different management teams and boards, but updating the corporate governance

documentation, would not deliver the level of reform required and it was therefore discounted.

4.11 Therefore, the working group discussions then focussed on their preferred option to create a single structure responsible for strategic and operational decision making with subsidiary companies holding operational assets as required. The working group agreed that:

- A single board with single executive team is critical to achieving the integrated approach which is a key driver of reform;
- A unified culture is essential for future integration and growth, recognising that any sense of “modal supremacy” should be avoided as this could be a threat to employee morale and an integrated identity;
- The company structure should be innovative, flexible and adaptable as it moves into the future;
- This outcome best reflected the objectives set out by Council and the transition principles agreed; and
- This outcome had the greatest potential to achieve efficiency and value for money savings.

4.12 In this option there are a number of further considerations which include ensuring:

4.12.1 That the board structure complies with the terms of the Transport Act 1985¹. The role of the board in decision making should be clearly stated to avoid confusion around roles and responsibilities;

4.12.2 The role of the Council and the minority shareholders (in Lothian Buses) is clear:

4.12.2.1 With any new arrangement recognising the key role of all of the shareholders as owners and ensuring their shareholding interest is reflected within the structure; and

4.12.2.2 On the role that partner local authorities have in developing key strategic and policy direction, recognising and ensuring that the structure enables a strong regional dimension to public transport delivery. This aligns closely with the ambition of the CMP and wider regional and national transport delivery.

4.12.3 That operational delivery is bespoke to each transport mode, given the differing regulatory and safety considerations which are dependent on mode.

4.13 In order to deliver this preferred approach, the working group concluded that a single company should contain ‘headquarters’ functions across all modes. The functions would include strategic direction, employee relations, passenger services, risk and compliance, marketing, and financial and commercial strategy. This is

¹ Transport Act 1985 s.73 (1) and (2) in terms of The Public Transport Companies (Permitted Maximum and Required Minimum Numbers of Directors) Order 1985

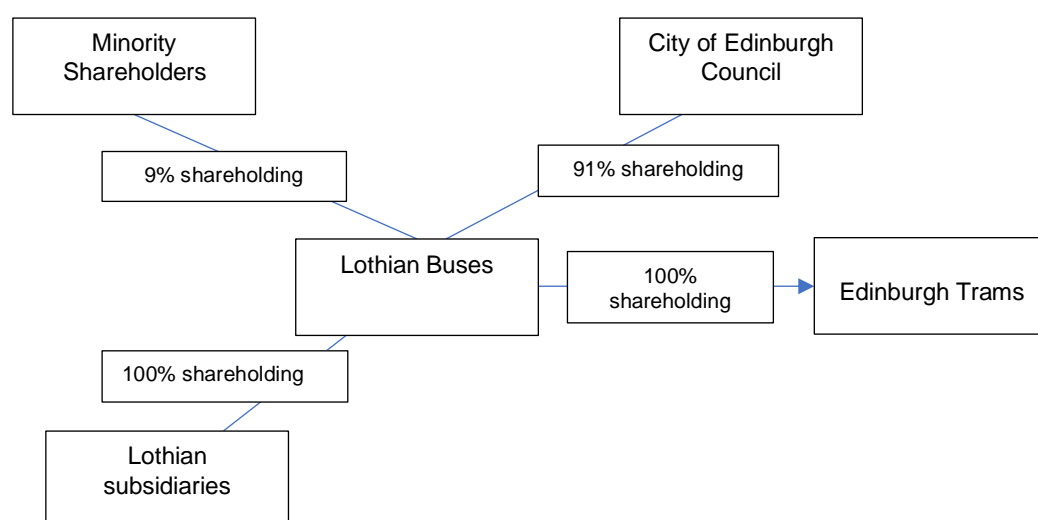
considered to be key to delivery of integrated transport and means that all strategic decision making takes place within a single entity.

- 4.14 It was considered by the working group to be essential that the transition to the new structure be supported by a change management process, which would set out the new vision and culture and create consensus and strong support for it within the new structure. An emphasis on multi modal delivery will be critical to delivering this new culture. While this would largely be the responsibility of the new Board (see below), the Council also needs to provide leadership, context and support to the process.
- 4.15 It was also agreed that that all modes of mobility policy and delivery should be represented at board level and that a senior executive team, with demonstrable experience of publicly owned transport delivery within a commercial environment, is established.
- 4.16 Two approaches were considered by the working group to achieve the preferred structure:
 - 4.16.1 The first was to establish a new company to deliver the required functions; and
 - 4.16.2 The second approach was to use the existing Lothian Buses corporate entity, but to reconstitute the company. This would mean that the company board would be completely reconstituted, with an amended Memorandum and Articles of Association and a revised Shareholder Agreement. All of these are considered to be of critical importance to ensure this is a wholly renewed company so that it is directed to deliver integrated public transport services rather than solely focussed on commercial bus operations and related business.
- 4.17 The working group noted that the first option was a development of the options previously considered however some participants felt that the second option, had not previously been considered and that this was a development of the single company option (which had previously been considered by the working group and discounted). There was a concern that the second option had not had the same level of scrutiny as other options, though since conclusion of the working group direct engagement has been undertaken.
- 4.18 In considering the two approaches, all members of the working group agreed that any industrial relations risk should be mitigated as far as possible both during the transition and in the end state corporate model. In addition, the issue of perceived 'takeover' or modal supremacy should be avoided.
- 4.19 The advantage of utilising a reconstituted Lothian Buses is that it minimises the risk of competing boards. In order to comply with the terms of the Transport Act 1985, Lothian Buses must retain three directors who are full time employees of the company. If Lothian Buses were a subsidiary to a new company, it would therefore need to have its own fully staffed board which could lead to conflicting positions

being taken between the boards. This is a key issue which the working group sought to avoid as the risk of fractured decision making is too high.

Preferred approach

- 4.20 Taking account of all considerations, the approach recommended is to progress to reconstitute the Lothian Buses corporate entity with an amended Memorandum and Articles of Association, to be responsible for multi modal public transport delivery.
- 4.21 The reconstituted company would be responsible for delivering all Council owned public transport modes in the city, rather than being responsible for bus alone. It would also be responsible for anticipating and developing new transport modes. Opportunities for growth of public transport within Edinburgh and the wider region should be identified and developed to support and enable policy delivery and for the commercial sustainability of the company.
- 4.22 Edinburgh Trams would be a subsidiary of the reconstituted company. This gives sufficient control to develop multi modal public transport delivery, and also avoids multiple boards which has resulted in conflicting priorities in the past.
- 4.23 A diagram showing the legal/shareholding structure is shown below:



- 4.24 It is important to stress that the revised Lothian company would be responsible for delivery of multi-modal public transport. Therefore, no pre-eminence of any particular mode in the approach to delivery will be permitted, rather, the focus of the group will be on mobility, customer service, and commercial and environmental performance. This approach will be reflected in every aspect of the organisational design of the company.
- 4.25 To progress this new approach:
- 4.25.1 A new shareholder agreement would be required. The role of the minority shareholders in the reconstituted company would remain and they should continue to have a Board observer as now. The shareholder agreement

would make clear that the profits and losses from Edinburgh Trams would be excluded from dividend to the minority shareholders. At Council officer level, a streamlined interface would be established to enable close working with dialogue to be established to work together on key policy issues. The Council would retain Board observer status;

4.25.2 Any revisions to Lothian Buses corporate documentation would make it clear that the new Board is to be responsible for existing and emerging transport modes, as directed by the owners of the company;

4.25.3 The Council would maintain formal political oversight through the existing committee structure;

4.25.4 As now, the commercial independence of the reformed company would be important (for legal and financial reasons), but key policies and practices would require the consent of the Council as majority shareholder in accordance with the terms of the new shareholder agreement;

4.25.5 Nominations will be sought from the existing Lothian Buses and Edinburgh Trams Boards to form the core of the new Board, to ensure continuity. An employee Board member from Lothian Buses would be sustained and an employee board member from Edinburgh Trams introduced. An advert for a new non-Executive Chair would be progressed, alongside an advert for new Board members. These appointments would reflect the need for leadership of a publicly owner multi modal transport and mobility company working in a competitive commercial environment;

4.25.6 Alongside an employee representative, the new Board would also welcome an observer from recognised Trade Unions for agreed agenda items;

4.25.7 The new board would be responsible for the appointment of the Chief Executive and the creation of a new senior management team with a process led by the policies of the company; and

4.25.8 At the appropriate time in the reform process, the Board of Transport for Edinburgh would be stood down. Any assets or liabilities of Transport for Edinburgh would be transferred into the Council or the reconstituted company. Thereafter Transport for Edinburgh would be wound down with all appropriate HR and legal processes being followed, as they will be across this whole process and in accordance with all relevant policies.

4.26 It is recognised there is significant value in the brands of the existing companies and therefore no changes to existing operating brands will take place.

4.27 This structure aligns with the objectives set, while mitigating the risks associated with transition. Detailed legal advice to date has not found any barriers to delivery of this structure however ongoing legal input for drafting the required corporate documentation will be required.

4.28 It is important to note that it has not been possible to achieve a consensus among the companies on this preferred approach. As a result, every effort has been made to address stated concerns in this report, and it will be important to ensure that

concerns are, where possible, further taken on board as implementation takes place.

5. Next Steps

- 5.1 If Committee approves progressing with the implementation of the preferred approach Council officers will work with the existing bus and tram boards to establish phased transition arrangements. An outline transition plan will be established identifying key deliverables and related timescales. This will include new or revised corporate material and arrangements for the recruitment of a new transition board which will be a matter for future Committee approval. It is envisaged that the transition board will become the board of the reconstituted legal entity.
- 5.2 Once formed the new transition board will work with Council officers for the final design and implementation of the transition process, that will then establish the new integrated transport group company through a reform of the Lothian Buses legal entity as set out in this report.
- 5.3 Council officers will support the transition process by developing a new shareholder agreement in conjunction with the transition board which will oversee the appointment of a Chief Executive and executive team and the creation and implementation of a change management plan. As per current arrangements key appointments and terms and conditions will be subject to Council consent.
- 5.4 In line with the intent of the new shareholder agreement, the transition board will be expected to adopt and follow corporate governance best practice including the formation of appropriate governance structures and the establishment of independent benchmarking arrangements to guide executive remuneration. In the initial first phase Council officers will ensure appropriate communication and continuing consultation with key stakeholders with this responsibility being shared with the transition board, once formed.
- 5.5 The existing bus and tram boards will continue to operate in parallel with the transition process, focussing on business continuity and Covid-19 recovery. These boards will also be expected to cooperate fully with the transition process and ensure that business decisions taken are consistent with reform objectives and do not prejudice the integration process.
- 5.6 Within a twelve month period, the transition to the new corporate arrangements should be substantially in place and the appointment of the Chief Executive should be underway.
- 5.7 Officers will work closely with the minority shareholders to support their political and executive approval processes.

6. Financial impact

- 6.1 To minimise the financial costs associated with the implementation of this change, it is proposed to utilise existing resources of the Council with support from the Transport ALEOs to manage the development and implementation of the proposed reform.
- 6.2 However, it is anticipated that an implementation manager will be required in addition to specialist external advice and Technical Assistance. Locating the resources for this function will be progressed if the report recommendations are approved.
- 6.3 It is anticipated that efficiencies can be found through greater integration of the public transport companies through enabling centralisation of resources and closer working operationally. However, it should be recognised that the integration of the transport companies, along with a clear relationship with the shareholders as envisaged at paragraph 4.12.2, enables efficient policy delivery and the efficiencies arising from a new structure in policy delivery should not be overlooked.

7. Stakeholder/Community Impact

- 7.1 Discussion with stakeholders has been taking place throughout this process. This will continue and widen as implementation begins. This will continue to include recognised Trade Unions.

8. Background reading/external references

- 8.1 None.

9. Appendices

- 9.1 Appendix 1 – Working Group Guiding Principles
- 9.2 Appendix 2 – Working Group transition principles

Appendix 1 – Working Group Guiding Principles

The group:

1. should work together to deliver the objectives of the reform, with all members working collectively to deliver these objectives rather than representing a particular mode;
2. should work collaboratively recognising mutual expertise and experience and with trust;
3. should be forward thinking whilst learning from the past and relevant experience elsewhere;
4. should deliver at pace with a commitment to fortnightly meetings lasting 2 hours;
5. should look to methodically gain agreement on and close off issues through the sequence of meetings; and
6. should inform a committee paper to be presented to the committee after conclusion of the working group process, which committee paper shall reflect the views of the group, including any points of contention or differences of opinion.

Appendix 2 – Transition principles

1. Create a customer focussed unified public transport approach through service integration, route optimisation and fare ticketing optimisation. Service delivery and investment decisions should reflect local, regional and national policy objectives, anticipating and responding to future developments, as well as the fast changing nature of the transport market place.
2. Mitigate industrial relations and HR risks due to any unnecessary transition complexity.
3. Minimise existing executive team disruption during the current COVID-19 pandemic and minimise impact of transition arrangements on post COVID-19 recovery.
4. Maintain a financially and operationally viable public transport service that meets the current and future mobility needs of customers across Edinburgh and the Lothians, including sufficient flexibility to respond to emerging trends and ideas in the transportation marketplace. The opportunity for minimal public subsidy, future dividends and efficiency benefits should also be optimised.
5. Ensure compliance with all relevant transport, employment, competition, and regulatory requirements.
6. The end state organisational model should reflect CEC desire to achieve a single corporate solution that maintains current public transport operating brands. This should also respect the existing rights of minority shareholders of Lothian Buses.
7. The board of the end state organisational model should have a strong commercial orientation, no political representation and have directors who have the requisite strategic, business and transport experience along with an understanding of the wider context in which publicly owned transport services operate. Employee board representation should also be a continuing feature.
8. An interface between the end state organisational model and CEC at officer level should be established to enable appropriate scrutiny, strategic guidance and policy formulation. Representation from the other Lothian local authorities should also be a consideration.
9. An interface between the end state organisational model and political oversight should be established to enable a direct discourse between elected members and the end state organisation along with appropriate reporting to relevant Council committees, both at City of Edinburgh Council and, where necessary, the minority shareholders.