

Release of the Settlement Agreement with HBS

Bedfordshire County Council can today confirm the cost of the termination of its strategic partnership with HBS.

The details of the settlement had been confidential but, following the Council's successful request to HBS that the Settlement Agreement be released to the public, the information can now be published.

Cllr Madeline Russell, Leader of the Council, said: "We have made a quick, clean break from our ties with HBS. We have taken over all HBS services and all the staff and assets involved in the delivery of those services.

"We were unhappy that, because of the nature of commercial negotiations, we had to keep the settlement terms confidential but we can now be open about the good deal we have made for Bedfordshire residents."

The Council considers and is so advised that HBS was in breach of a number of its obligations under the Services Agreement. As part of the Settlement Agreement, the Council agreed to withdraw its notice of termination and replace it with agreed voluntary termination.

The legal advice to the Council is that it has secured an extremely favourable settlement. The Council has paid HBS a one-off sum of £6.75 million, made up of:

- * £4.7 million to purchase assets such as IT, furniture and fittings used by HBS to provide services to the Council. This was in accordance with the terms of the HBS contract which terms applied on the termination of the contract for any reason. These assets cost HBS over £6.7 million to provide.

- * £2.05 million to acquire goodwill, contracts and services provided by HBS, including to schools and other organisations. Some of these are trading services which will generate revenue to offset costs to council tax payers.

Cllr Russell added: "We have taken a critical step in our drive to Transform Bedfordshire. We have terminated our contract with HBS not to save money, but to improve quality and performance and work towards our goal of excellence.

"It has taken us less than two months to move from initial action against HBS to an amicable conclusion, and this has been achieved at a cost well within our estimates. We are confident that we've achieved a very good deal for the Council and for Bedfordshire residents."

Notes:

- * The contract between HBS and the Council was signed in June 2001. It was due to last for 12 years and was expected to have a total value exceeding £250 million.

- * Bedfordshire County Council took over the services formerly run by HBS Bedfordshire, including services to individual schools, on 15 August 2005. The Council had been dissatisfied with the services provided by HBS and in July 2005 issued a notice of termination. The intention of the notice was to require HBS to remedy what the Council regarded as specified 'contractor defaults' and thereby achieve an improvement in the services provided to the Council by HBS or, failing remedial action by HBS, for the Council to take over the operation of the services with a view to creating improved and more responsive services.

- * The Council has paid a further £949,784 to HBS. This is payment for laptop computers which HBS has supplied to schools. That payment was due regardless of the Settlement Agreement.

* A further £1 million has been allocated from Council reserves to cover transitional management and legal costs.

* The process of setting next year's budget and council tax is only just beginning but it is anticipated the impact on council tax payers due to the settlement agreement will be limited to the cost of borrowing to purchase the assets - assets which are now owned by the Council and used to deliver services.

* Separately, HBS will be paying the Bedfordshire Pension Fund for the full pension deficit that has built up in respect of HBS staff since 2001. While the exact amount of this payment is subject to an actuarial valuation, it is estimated to be in the region of £2.3m.

* The ODPM were not involved in the talks with HBS. Negotiations followed an independent mediation process.

* 547 staff transferred from HBS to Bedfordshire County Council. A full breakdown is available from the Press Office upon request.

DATED: 2005

(1) HBS BUSINESS SERVICES GROUP LIMITED ("HBS")

-and-

BEDFORDSHIRE COUNTY COUNCIL ("BCC")

Settlement Agreement

Kilpatrick

Stockton LLP

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THIS AGREEMENT is made on 12th day of August 2005

BETWEEN:

(1) HBS Business Services Group Limited, whose registered address is Carmelite, 50 Victoria Embankment, Blackfriars, London, EC4Y 0DX ("HBS"); and

(2) Bedfordshire County Council of County Hall, Cauldwell Street, Bedford, MK42 9AP ("BCC");

together "**the Parties**"

RECITALS

A. On 3rd April 2001 and 1st June 2001 respectively, the Parties entered into a Partnership Agreement and an Agreement for the provision of Services ("The Services Agreement"), (together "**the Core Contracts**") which, inter alia, provided for the provision of services by HBS to BCC over a 12 year period. Unless otherwise stated herein, all defined terms shall have the meaning ascribed to them under the Core Contracts.

B HBS also provides a range of educational services to schools in Bedfordshire including: direct contracts with individual schools for the supply of equipment and materials; Schools Bursary; Schools HR; IT Support Strategy and Cover Card; Educational Consultancy provided both on a direct purchase by Schools basis; HEART, Fire and Police and Probation services (collectively referred to as "**the Education Services**").

C. On 12th July 2005, pursuant to clause 44.2 of the Services Agreement, BCC served a written "Notice of Termination" ("**the Notice**") on HBS, claiming that HBS was in breach of a number of its obligations under the Services Agreement and that the Services Agreement would terminate on the 15th August 2005, unless the "Contractor Default" specified in the Notice was remedied on or before that date (if capable of remedy). BCC also asserted a right to claim damages from HBS.

D. HBS denied (and continues to deny) that it is in breach of its obligations under the Services Agreement as alleged by BCC and disputes the validity of the Notice.

E. In response to the Notice, HBS claimed that BCC was in repudiatory breach of the Services Agreement and purported to accept the Notice and BCC's conduct as bringing the Services Agreement to an end subject only to HBS' right to claim damages against BCC. BCC denies (and continues to deny) that it is in repudiatory or other breach of the Services Agreement.

F. The Parties are desirous to settle the Disputes that have arisen under the Services Agreement ("**the Disputes**") amicably and have agreed to enter into a full and final settlement, on the terms set out below.

1. INTERPRETATION

1.1 Construction

1.1.1 The headings in this Agreement are inserted for convenience only and shall not affect its construction or interpretation and references to a clause (unless otherwise stated) refer to a clause in this Agreement.

1.1.2 Any reference in this Agreement to "this Agreement", unless the context otherwise requires, shall be construed as a reference to this Agreement as it may from time to time be amended, varied, supplemented, novated or replaced and shall include any document which is supplemental to, is expressed to be collateral with, or is entered into pursuant to or in connection with, the terms of this Agreement.

1.1.3 The illegality, invalidity or unenforceability of any provision of this Agreement under the law of any jurisdiction shall not affect its validity or enforceability under the law of any other jurisdiction.

1.1.4 Save where the context otherwise requires, the plural of any term includes the singular and vice versa.

1.1.5 Any reference in this Agreement to any statute or statutory provision shall, unless the context otherwise requires, be construed as a reference to such statute or statutory provision as in force at the date of this Agreement and as subsequently re-enacted or

consolidated and shall also include all instruments, orders and regulations for the time being made thereunder or deriving validity therefrom.

2. TERMS OF SETTLEMENT

2.1 BCC has agreed to withdraw the Notice. Instead the parties have agreed to the voluntary termination (which for the avoidance of doubt, is not voluntary termination pursuant to clause 47 of the Services Agreement) of the entirety of the Core Contracts with effect from midnight on the 14th August 2005, and have agreed to the assignment and /or transfer of all HBS' rights and obligations in respect of the Education Services to BCC.

2.2 BCC shall pay HBS the sum of Six Million Seven Hundred and Fifty Thousand (6,750,000) Pounds sterling without discount, abatement, or set off, in cleared funds no later than Monday 15th August 2005, in respect of the termination of the Core Contracts and the assignment and / or transfer of the Education Services to BCC. In the event that payment of this agreed sum, or any part of it, is not made on or before the 15th August 2005, then interest at a compound rate of 8% per annum / pro rata shall become due and payable by BCC to HBS in respect of any sum remaining due and outstanding.

2.3 The Parties agree however that nothing contained herein shall be deemed to effect the amounts already due and owing between the parties as set out in the balances list attached as Schedule 3. The amounts set out on that list (to the extent that they have not already been paid) shall be settled and paid in full in cleared funds no later than 15th August 2005. In the event that payment of the agreed sums, or any part of them, is not made on or before the 15th August 2005, then interest at a compound rate of 8% per annum / pro rata shall become due and payable in respect of any sum remaining due and outstanding beyond the 15th August 2005.

2.4 BCC agrees that all staff appearing on schedule 2 (titled "TUPE Transfer List") were part of the staff employed in or assigned to HBS' business engaged in delivering services pursuant to the Core Contracts and the Education Services, at midnight on the 14th August 2005 and that those staff members shall either by operation of law, or pursuant to this Agreement, transfer to BCC pursuant to the Transfer of Undertakings (Protection of Employment) Regulations ("TUPE") with effect from midnight on the 14th August 2005.

2.5 If any contract of employment of any employee on the TUPE Transfer List is held by an Employment Tribunal or relevant court of law to continue with HBS on or after 15th August 2005, BCC agrees that:

(i) in consultation with HBS, it will within ten business days of being requested by HBS make to that person an offer in writing to employ him under a new contract of employment to take effect upon the termination referred to below; and

(ii) that offer of employment will be on terms and conditions which, when taken as a whole, do not materially differ from the terms and conditions of employment of that person immediately before 15th August 2005 (save as to the identity of the employer and any terms relating to an occupational pension scheme).

Upon that offer being made by BCC, or at any time after the expiry of ten business days from a request by HBS for BCC to make that offer, HBS shall terminate the employment of the employee concerned and BCC shall indemnify HBS against any demands, claims, actions, proceedings, damages, payments, losses, costs, expenses, or other liabilities in connection with the employment of that employee from 15th August 2005 until the termination of that employment.

2.6 If any contract of employment of any person who is not an employee on the TUPE transfer list is held by an Employment Tribunal or relevant court of law to have effect pursuant to TUPE on or after 15th August 2005 as if it was a contract of employment originally made with BCC, HBS agrees that:

- (i) in consultation with BCC, it will within ten business days of being so requested by BCC make to that person an offer in writing to employ him under a new contract of employment to take effect upon the termination referred to below; and
- (ii) that offer of employment will be on terms and conditions which, when taken as a whole, do not materially differ from the terms and conditions of employment of that person immediately before 15th August 2005 (save as to the identity of the employer and any terms relating to an occupational pension scheme).

Upon that offer being made by BCC, or at any time after the expiry of ten business days from a request by BCC for HBS to make that offer, BCC shall terminate the employment of the employee concerned and HBS shall indemnify BCC against any demands, claims, actions, proceedings, damages, payments, losses, costs, expenses, or other liabilities in connection with the employment of that employee from 15th August 2005 until the termination of that employment.

2.7 As at midnight on the 14th August 2005 the assets listed on the Asset Transfer List identified on Schedule 1, shall transfer absolutely from HBS to BCC on an as is, where is basis and the parties agree that no express or implied terms and conditions shall apply relating to quality, condition, and/or fitness for purpose. HBS does however expressly warrant that it has full and unencumbered title to the assets listed on Schedule 1 and can therefore transfer full and good title to BCC. For the avoidance of doubt, all assets, equipment and rights (including licenses in respect of third party software) within Bedfordshire used by HBS to provide the Services in accordance with the Services Agreement and the Education Services shall transfer absolutely to BCC on the basis set out in this clause. HBS will transfer to the BCC the benefit of all supplier's warranties relating to the assets and/or equipment referred to in this clause with effect from 15th August 2005.

2.8 HBS hereby agrees to assign and / or transfer to BCC all third party contracts appearing in Schedule 4 to the full extent allowed by law. In the event that the third party contracts listed in Schedule 4 are non-assignable or non – transferable then HBS shall hold the benefit of such third party contracts in trust for BCC and BCC undertakes and agrees to perform all the obligations of HBS under the third party contracts and shall hold HBS harmless and indemnified from any and all claims that might arise on or after the 15th August 2005 under the said third party contracts listed in Schedule 4. For the avoidance of doubt, all third party contracts supporting HBS's delivery of the Services in accordance with the Services Agreement and the Education Services shall be assigned and/or transferred on the basis set out in this clause.

2.9 BCC agrees that HBS' corporate finance team shall continue to be provided with access to and accommodation within County Hall for a period of three months from 15th August 2005 for an inclusive sum of £5,000. BCC anticipates that the Corporate Finance team will remain in their existing offices on the 6th Floor of County Hall but in case they have to be removed for operational reasons, then they will only be moved to the existing Board Room on the 6th Floor of County Hall. HBS will bear the costs of moving telephone and computer connections and links.

2.10 Upon signing this Agreement, the Notice shall be deemed to be withdrawn from the moment that the agreed voluntary termination takes effect. The parties have agreed to issue the joint press statement attached at Schedule 5.

2.11 Each party hereunder shall be responsible for and shall bear their own tax liabilities if any.

2.12 This Agreement is without prejudice to the continuing obligations of HBS under an Admission Agreement dated 1st June 2001 made between BCC (in its capacity as an Administering body under the Local Government Pensions Scheme Regulations 1997) and HBS and in particular the obligations of HBS under clause 7.2 of the Admissions Agreement. HBS undertakes that until it has discharged its liabilities under the

Admissions Agreement, the related Guarantee Bond dated 1st June 2001 made between BCC (1), HBS (2) AND National Westminster Bank plc (3) (Guarantee Bond No. TSPYG257618), shall remain in full force and effect. For the sake of clarity, the parties agree that HBS shall not be required to provide any revised contribution requirement before 15th August 2006.

2.13 HBS agrees to continue to hold the licence (registration No 509740) for the operation of the Early Birds Nursery for either four weeks from the date of this Agreement, or until such time as BCC are able to obtain a licence in their own name, whichever occurs first. BCC shall indemnify and hold HBS harmless in respect of any and all liabilities arising after midnight on the 14th August 2005 in connection with the continued operation of this Nursery facility. BCC undertakes that in so far as it is within their reasonable control, there will be no staff changes within the above time.

2.14 By 22nd August 2005 HBS will deliver to BCC any books, records, assets, equipment, hardware, plant and machinery and council data under its control which belong to BCC (including the Council Network (to the extent capable of delivery) and the Council Hardware).

2.15 HBS hereby grants, in respect of the Contractor Software and the Specially Written Contractor Software, to BCC a non-exclusive, royalty-free, perpetual and irrevocable licence to use, reproduce, modify, adapt, translate, enhance and maintain such software (and to grant sublicenses to do the same) for its own internal purposes (including the receipt of services by it from third parties and the supply of services by BCC to third parties) provided that BCC shall not sub-licence such Software to Third Parties (other than its employees, subcontractors, and agents) except in connection with services provided to that Third Party by BCC.

2.15.1 HBS shall deliver to BCC the source code and the object code versions of the Specially Written Council Software and Council Software as currently configured to provide the Services to BCC and all relevant documentation.

2.15.2 HBS hereby grants to the BCC a non-exclusive, perpetual, royalty-free and irrevocable licence to use, copy, modify, adapt, translate and enhance any item or documentation (and the right to grant sub-licenses to do the same) in respect of which the Intellectual Property Rights are owned by HBS and which are necessarily used in connection with, and to the extent necessary for, the provision or receipt of the Services for its own internal purposes (including the receipt of services by it from third parties and the supply of services by BCC to third parties) provided that BCC shall not sub-licence such Intellectual Property Rights to Third Parties (other than its employees, subcontractors, and agents) except in connection with services provided to that Third Party by BCC.

2.15.3 HBS shall provide BCC with copies of all relevant information in its possession relating to the use and operation of the Hardware and the Software (including information on the interfacing of the Specially Written Software with any elements of the Council Software, Contractor Software and/or the Third Party Software).

2.15.4 HBS shall co-operate with BCC to provide BCC with:

- a. complete lists of, and full specifications for and configurations of, the Hardware and Software used to provide the Services; and
- b. complete lists of the licences, support and maintenance and all other contracts relating to the Hardware and Software.

3. CONFIDENTIALITY

The Parties agree to keep confidential the terms of this Agreement save that (for the avoidance of doubt) the Parties and their legal advisers may disclose this Agreement:

- 3.1 to their shareholders, and members, or pursuant to an order of the court, by compulsion of law, or to the respective Parties' auditors; and
- 3.2 to the extent required in order to secure compliance with this Agreement, and in the event of breach by the other party.

4. NON-ADMISSION OF LIABILITY

It is expressly agreed and acknowledged by the Parties that the execution and performance of this Agreement is not, and is not to be construed as, an admission of any liability whatsoever on the part of any party other than to perform this Agreement.

5. PERFORMANCE BOND

For the sake of clarity BCC shall make no claim under the performance guarantee bond issued by the National Westminster Bank plc, (reference TSPCYG257617) dated 1st June 2001, and upon the signing of this Agreement the performance guarantee bond shall be returned to HBS for cancellation by no later than 19th August 2005.

6. LITIGATION

HBS warrants that there are no known litigation, arbitration, mediations or administrative or criminal proceedings which have been instituted against HBS which relate directly to the Services and which will relate directly to the employees on the TUPE Transfer List or the Transferring Assets.

7. DATA PROTECTION

HBS warrants that it is not aware of any failure to comply, in connection with its performance of the Services, with the relevant requirements of the Data Protection Act 1984 (while that Act was in force) and with the relevant requirements of the Data Protection Act 1998.

8. WARRANTIES

HBS warrants that :

8.1 it is not paying to any employees on the TUPE Transfer List any ex gratia relevant benefits (as defined in section 612(1) of the Income and Corporation Taxes Act 1988) to any of the said Employees or to any spouse, child or dependant of any of them.

8.2 There are no outstanding claims by any employees on the TUPE Transfer List against HBS relating to or in connection with the Local Government Pension Scheme or any other pension arrangement which the said employees are members of and, so far as HBS is aware, there are no matters likely to give rise to such claims other than routine claims for benefits.

8.3 HBS warrants that it has not carried out in relation to any employee on the TUPE Transfer List any of the following acts:

a. the termination of employment for any reason whatsoever save where, in the reasonable opinion of HBS, such termination was justified by reason of redundancy or due to the actions of any such employee; or

b. the alteration or change in any way of any terms and conditions of employment of any such employee (whether with or without the consent of the employee) on or after 12 July 2005.

8.4 HBS shall use its reasonable endeavours, by 19th August 2005, to provide BCC:

a. full details (to the extent that they exist and HBS has access to) of all employees on the TUPE Transfer List including, but not limited to, details of terms and conditions of employment and benefits (including but not limited to any bonus, incentive, profit sharing scheme, employee share scheme and life, accident and health insurance), working arrangements, outstanding obligations to increase remuneration, recognition agreements and redundancy schemes (including all those persons temporarily absent from work for any reason; for example maternity leave, sick leave or holiday); and

b. (to the extent that they exist and HBS has access to) copies of all personnel and employment records (including without limitation National Insurance and PAYE records), employment contracts and statements of terms and conditions of employment and disciplinary records relating to employees on the TUPE Transfer List.

8.5 HBS agrees to discharge all obligations and liabilities in respect of the contracts of employment of employees on the TUPE Transfer List arising or accruing up to and including 14th August 2005, and will indemnify BCC in respect of any liability arising from any act or omission of HBS in relation to such contracts of employment on or before that date.

9. LAW AND JURISDICTION

9.1 Law: This Agreement and the rights and obligations of the Parties hereto shall be governed by and construed in accordance with English law.

9.2 Jurisdiction: Each of the Parties to this Agreement agrees that the High Court shall have exclusive jurisdiction to hear and determine, any suit, action or proceeding, and to settle any dispute, which may arise out of or in connection with this Agreement and, for such purposes, irrevocably submits to the jurisdiction of such court.

10. SEVERABILITYIn the event that any provision of this Agreement or any part of any provision shall be determined to be partially void or unenforceable by any Court or body of competent jurisdiction or by virtue of any legislation to which it is subject or by virtue of any other reason whatsoever, it shall be void or unenforceable to that extent only and no further and enforceability of any of the provisions or the remainder of any such provision shall not be affected thereby.

11. CONTRACTS (RIGHTS OF THIRD PARTIES) ACT 1999No term of this Agreement is enforceable under the Contracts (Rights of Third Parties) Act 1999 by a person who is not a party to this Agreement.

12. ENTIRE AGREEMENTSubject to the terms of this Agreement, this Agreement will supersede all other agreements or discussions whether written or oral between the Parties and comprises the entire agreement between the Parties with respect to the subject matter described in it. This Agreement may only be varied in writing signed by the Parties. This Agreement shall be binding on and inure for the benefit of the successors in title of the Parties and the benefit and or burden of the same shall not be assignable.

13. COSTS Each party confirms that it shall bear its own legal costs incurred in connection with the Disputes and any matters related thereto. Each party hereto shall bear 50% of the total costs of the Mediation taking place in London in August 2005.

14. FULL AND FINAL SETTLEMENT

The terms of settlement agreed by the Parties and set out in this Agreement are in full and final settlement of all claims as to damages, interest and costs that one party may have against the other howsoever arising, whether in contract tort or otherwise, arising from or in relation to the Core Contracts and the Education Services, the termination of the Core Contracts and the assignment or transfer of the Education Services or otherwise. Without prejudice to the generality of the foregoing, it is expressly agreed that the said terms of Agreement are in full and final settlement of: (a) all claims and causes of action that HBS may have against BCC, its officers and members referred to in correspondence passing between Kilpatrick Stockton (solicitors for HBS) and Mayer Brown Rowe & Maw (solicitors for BCC) or otherwise, including such claims and causes of action in defamation, malicious falsehood and wrongful interference in third party contracts; and (b) all claims and causes of action that BCC may have against HBS, its directors and employees referred to in the said correspondence or otherwise.

.....

Signed by a duly authorised signatory

For and on behalf of

HBS Business Group Services Limited

.....

Signed by a duly authorised signatory

For and on behalf of

Bedfordshire County Council

IN THE MATTER OF A SETTLEMENT AGREEMENT

BETWEEN:

HBS BUSINESS SERVICES GROUP LIMITED

and

BEDFORDSHIRE COUNTY COUNCIL

ADVICE

Introduction

1. In April 2001, Bedfordshire County Council (the "**Council**") and Hyder Business Services Group Limited Hyder Business Services Group Limited changed its name to HBS Business Services Group Limited on 19 June 2002 ("**HBS**") entered into a "Partnership Agreement". On 1 June 2001 the Council and HBS entered into an agreement (the "**Services Agreement**") for the provision of services by HBS to the Council.
2. The documentation is voluminous. The Services Agreement (as amended) runs to some 69 clauses (165 pages), 36 Schedules and various Appendices containing detailed Output Specifications.
3. The Partnership Agreement was for the most part not legally binding; it terminated automatically (including to the extent that it was legally binding) if the Services Agreement were terminated unless the parties agreed otherwise.
4. The Partnership Agreement and the Services Agreement both came into effect on 1 June 2001 with an intended life of 12 years and an expected value exceeding £250 million. In June 2001, 550 Council employees transferred to HBS under the Transfer of Undertaking Regulations. The Services to be provided by HBS to the Council were divided into a number of Service Elements such as Financial Services, Human Resources and IT Services.
5. The sums payable each financial year by the Council to HBS for the provision of services was known as the Unitary Charge There was a separate "Education Unitary Charge" in respect of Education Services provided to or through the Council. There were also separate contracts between HBS and individual schools (and others) to which the Council was not a party. and was payable in respect of various Service Elements such as Financial Services and Human Resources Services.
6. There were specifications for each of the various Service Elements. All of the services had a Specification 1 which described the services as they were when they transferred to HBS on 1 June 2001. That was the minimum standard of service delivery required of HBS. Many of the Service Elements had a Specification 2 which required changes/improvements to the way in which the services were to be delivered by 1 April 2003 or, in the case of Human Resources, by 1 April 2004.

7. As part of the Specifications for the Service Elements there were a number of Performance Indicators ("**PIs**") and Key Performance Indicators ("**KPIs**"). Some KPIs and PIs were monitored monthly whereas others were monitored quarterly or annually. KPIs were linked to the Price Performance Mechanism in the Services Agreement and failure by HBS to meet the standard required by a KPI could result in a deduction of money from the Unitary Charge. KPIs did not, for the most part, measure the quality of service provided. KPIs were part of the mechanism for payments to HBS. HBS was required by the Services Agreement to provide the Services in compliance with the Specifications, not simply to meet KPIs and PIs. The responsibility for the delivery of the Services in accordance with the Specifications rested with HBS.

1 Hyder Business Services Group Limited changed its name to HBS Business Services Group Limited on 19 June 2002

2 There was a separate "Education Unitary Charge" in respect of Education Services provided to or through the Council. There were also separate contracts between HBS and individual schools (and others) to which the Council was not a party.

8. Under the Services Agreement HBS was responsible for all aspects of SAP (underlying technology) as set out in Schedule 32 to the Services Agreement including its design, implementation, development, provision of business processes training and documentation. HBS was also responsible for the provision of interfaces.

The performance of HBS under Services Agreement

9. The Services Agreement placed a contractual obligation on HBS to perform the Services in accordance with the relevant Service Requirements (as set out in Specifications) and the provisions of the Services Agreement (clause 4.2). HBS was further required to perform the Services "*in a good and professional manner and with sufficient resources, including project management resource*" (clause 4.13).

10. The Council commissioned RSM Robson Rhodes to carry out a Review of Financial Management. In parallel, the Council commissioned LogicaCMG to review the SAP processes. RSM Robson Rhodes and LogicaCMG were each instructed to conduct their reviews and identify issues as though the Council and HBS were a single organisation; RSM Robson Rhodes and LogicaCMG were instructed not to seek to apportion responsibility for issues between the Council and HBS. The Robson Rhodes report, May 2005, was critical of Financial Management and Internal Controls. Financial Management and the internal controls in the finance systems are part of the Financial Services which had been provided to the Council by HBS since 2001. The Logica report identified 46 critical issues in respect of the SAP processes, the responsibility for which the Council considered and was advised lay with HBS.

11. The Council was deeply dissatisfied with the performance of HBS. The Council took the view and was advised that HBS had not delivered the contracted level of service to the Council, even less contracted improvements to the Services, including the contractual requirement for Continuous Improvement. Some of the Council's Best Value Performance Indicators (assessed by the Audit Commission) had deteriorated rather than improved. The Council considered and was advised that HBS was in substantial breach of contract including, in particular, in respect of the performance of the Services comprised in both the Finance Service Element and the Human Resources Service Element.

12. The Council considered and was advised that HBS was in breach of contract in relation to other Service Elements. For example, in relation to Social Services, the Council took the view and was advised that HBS had failed properly to manage BUPA and Homecare contracts, had failed to provide proper budget management and had failed properly to manage 'safe custody' accounts.

13. Without prejudice negotiations between HBS and the Council failed to resolve the position in any way which would have protected the interests of the Council, service recipients and Council taxpayers. The Council took legal advice as to the options open to the Council.

14. At a Special Executive meeting held on 12 July 2005, the Council decided to serve a written termination notice on HBS, pursuant to clause 44.2 of the Services Agreement, terminating the Services Agreement on 15 August 2005 unless what the Council considered and was advised was the "Contractor Default" (as defined in clause 1.1 of the Services Agreement) specified in that notice was remedied on or before that date (if capable of remedy). The specified "Contractor Default" was set out in 5 Appendices to the written termination notice.

15. The "Contractor Default" specified in Appendices to the written termination notice included what the Council considered and was advised were breaches by HBS of its obligations under the Services Agreement which materially and adversely affected the performance of the Services comprised in 2 or more Service Elements (including the Finance and Human Resources Service Elements) and material breaches by HBS of its obligations under the Services Agreement (a breach of which did not of itself directly impact on the quality of performance of the Services).

16. In its written termination notice dated 12 July 2005 the Council drew the attention of HBS to the provisions of clause 48.1 of, and Schedule 17 to, the Services Agreement (exit arrangements). The Council requested and required the co-operation and assistance of HBS in connection with the transfer of responsibility for the Services to the Council.

17. In order to assist the Special Executive meeting (and Members generally), a written commentary in summary form in respect of what the Council considered and was advised were breaches of contract by HBS in relation to the Finance Service Element was appended to the report to the Special Executive. Those breaches included:

- * Late preparation of the Council's accounts for 2003/04.
- * Failure to provide and maintain adequate financial controls. That failure in 2003/4 led to (a) the Council's Accounts for 2003/4 being heavily qualified by the District Auditor and (b) knock-on consequences for the Accounts for 2004/5.
- * Discrepancies in the General Ledger particularly in respect of data from payroll.
- * Failure to keep records of debtors in respect of residential care accounts.
- * Failure to observe good industry practice and standards in respect of reconciliation of accounts.

Those breaches of contract led to the Council's District Auditor issuing section 11 (Audit Commission Act 1998) recommendations to the Council.

18. A similar commentary in summary form in respect of what the Council considered and was advised were breaches of contract by HBS in relation to the Human Resources Service Element was also appended to the report to the Special Executive. Those breaches included:

- * The repeated failure over four years to provide a computerised HR Management Information System capable of providing "*comprehensive accurate and timely HR performance management reports*".
- * Failure to provide or maintain accurate employee data.
- * Failure to provide "modern recruitment and selection methodologies using leading-edge practices".
- * Failure to make statutory returns in respect of teacher's pensions.

The response by HBS

19. On 13 July 2005, HBS purported to accept what it alleged was a repudiatory breach of the Services Agreement by the Council in serving the said written termination notice.

20. Acting in accordance with legal advice, the Council strongly disputed the allegation that it was in repudiatory breach of contract.

Mediation

21. It was therefore common ground between HBS and the Council that the Services Agreement would terminate no later than 15 August 2005 as a result of the written notice of termination served by the Council or as a result of the acceptance by HBS of the alleged repudiatory breach of contract by the Council.

22. Given the differing positions taken by HBS and the Council, major litigation looked inevitable. The Council was advised that High Court proceedings would take some 2 years to come to trial culminating in a trial hearing of not less than 6/8 weeks (and possibly up to 4/6 months), with legal costs of not less than £5 million on each side. In addition to legal and other litigation costs (e.g. expert witness fees), litigation would inevitably have required the commitment of a high level of senior management and other resources to the litigation process over the 2 year period culminating in a trial hearing. These estimates do not include any provision for the substantial costs of, and the management and other resources involved in, an appeal by either party.

23. Against that background, HBS and the Council agreed to engage in mediation which took place in London on 4, 5 and 12 August 2005. And on 6 and 13 August 2005 in that the mediation sessions on 5 and 12 August 2005 continued until 12.45 a.m. on each occasion!

The Settlement Agreement

24. The mediation was successful and a Settlement Agreement (and accompanying side letter) was entered into in full and final settlement of all claims that HBS may have had against the Council and vice versa. On 12 August 2005, the Council and HBS agreed that the Services Agreement and the Partnership Agreement were to terminate at midnight on 14 August 2005. The Council therefore achieved a resolution of its dispute with HBS within one month of service of the written termination notice.

25. Reference should be made to the Settlement Agreement and side letter for their full terms and effect. In summary, however, the Council has paid HBS a one-off sum of £6.75 million, made up as follows:

- £4.7 million to purchase assets such as IT, furniture and fittings used by HBS to provide services to the Council under the Services Agreement. That was in accordance with the terms of the Services Agreement. Those assets cost HBS over £6.7 million to provide.

- £2.05 million to acquire goodwill, contracts and services provided by HBS including services provided to third parties pursuant to contracts (to which the Council was not a party and which were not therefore the subject of the written termination notice) with individual schools and with Fire, Police and Probation Services.

26. Under the terms of the Settlement Agreement, HBS will be making a payment (supported by a bank guarantee) to the Council (as administering authority for the Bedfordshire Pension Fund) in respect of the pension deficit which has arisen in relation to HBS staff since 2001. That payment will be determined by an actuarial valuation but is estimated to be in the region of £2.3 million.

27. Pursuant to the Settlement Agreement, 547 staff transferred from HBS to the employment of the Council at midnight on 14 August 2005.

3 These estimates do not include any provision for the substantial costs of, and the management and other resources involved in, an appeal by either party.

4 And on 6 and 13 August 2005 in that the mediation sessions on 5 and 12 August 2005 continued until 12.45 a.m. on each occasion!

5 Those terms applied on the termination of the Services Agreement for whatever reason.

Advice

28. In the course of the mediation, I advised the Council's decision makers and others in the Council's mediation team that the proposed settlement (as now embodied in the Settlement Agreement) was well within the range of lawful options open to the Court and, further, that the proposed settlement was an extremely favourable settlement which I recommended to the Council. That advice I now repeat.

29. In advising the Council that the settlement was both lawful and extremely favourable to the Council, I had regard to the following:

(1) The purchase by the Council of assets for £4.7 million used by HBS to provide services to the Council under the Services Agreement (at a price which reflected the terms of the Services Agreement Those terms applied on the termination of the Services Agreement for whatever reason. and at a price which was some £2 million less than the cost to HBS of providing those assets) was a purchase for value. The Council made a payment but received assets in return.

(2) The acquisition by the Council of goodwill, contracts and services provided by HBS including services provided to pursuant to contracts to which the Council was not a party (and which were not therefore the subject of the written termination notice) had the following advantages to the Council.

(a) the Council has acquired trading services which will generate revenue to offset costs to Council taxpayers. The Council had no right, in consequence of the termination of the Services Agreement or otherwise, to take over those services but has achieved this by negotiation. The Council considers that not only has it achieved a favourable deal in this respect (as in others) but also that it will be able to improve the quality of services provided to schools which is in itself in the public interest;

(b) the Council has achieved a clean break in its relationship with HBS. That was important to the Council (although unquantifiable in monetary terms) not least because of the time and resources that the Council was expending in seeking to manage that relationship.

(c) the Council has achieved a full and final settlement in consequence of which:

(i) there is a saving in legal and other litigation costs (estimated at not less than £5 million Even if the Council had been entirely successful in litigation with HBS, it would likely have incurred legal costs of not less than £1.5 million which would not have been recoverable from HBS.) that would otherwise have been incurred;

(ii) there is a substantial saving in terms of senior management and other resources which otherwise would have been diverted from service provision to participation in the legal process over (at least) a 2 year period. Those resources can now be used productively in the interests of citizens;

(iii) litigation risk is eliminated. HBS's claim against the Council was for some £14.4 million in addition to its proper claim for payment in respect of assets transferring to the Council. Legal advice to the Special Executive meeting on 12 July 2005 was that HBS would likely claim some £14 million and that often when major contracts are terminated it is rare for the fault to be on one side only and that some payment is made to the contractor. The Special Executive decided in effect that the litigation risk was worth taking in view of the advantage to the Council of terminating its relationship with HBS. For the relatively modest payment of £2.05 million, the Council has acquired for value contracts and trading services which are revenue producing Estimated by HBS at some £800 k per annum. (and which were not the subject of the written termination notice) and the Council has eliminated all litigation risk and ongoing expenditure on legal and other litigation costs arising from its decision to terminate the Services Agreement (and in consequence the Partnership Agreement); and

(d) the Council has removed what it considered to be a substantial impediment (unquantifiable in financial terms) to its "Transforming Bedfordshire" agenda and is now in a position to address the concerns expressed by the District Auditor. The settlement will enable the Council to focus its efforts on improving services in the public interest.

30. It is therefore apparent, and I so advise, that there are both financial and non financial benefits accruing to the Council in consequence of the settlement embodied in the Settlement Agreement. HBS assets have been purchased for value in accordance with the Services Agreement. Further assets (goodwill, contracts and services) have been acquired for value which includes a modest sum to eliminate litigation risk and future exposure to legal and other litigation costs. The Settlement Agreement also confirms the liability of HBS to make a payment of some £2.3 million (backed by a bank guarantee) into the Bedfordshire Pension Fund. The Council has in addition achieved benefits (unquantifiable in financial terms) referred to above.

Conclusion

31. I consider that the Council's negotiating team at the mediation protected the interests of recipients of Council services and the interests of local taxpayers and held out for and struck a hard and favourable bargain. I advise that the settlement achieved was not only lawful but also was an extremely favourable commercial settlement from the point of view of the Council, its service recipients and local taxpayers.

6 Even if the Council had been entirely successful in litigation with HBS, it would likely have incurred legal costs of not less than £1.5 million which would not have been recoverable from HBS.

7 Estimated by HBS at some £800 k per annum.

TONY CHILD

Mayer, Brown, Rowe & Maw LLP

5 September 2005

09/09/2005 Andrea Hill

