

Birmingham City Council

Report to Cabinet

22 May 2019



Subject: Highway Maintenance and Management PFI Contract

Report of: Director, Inclusive Growth

Relevant Cabinet Members: Councillor Waseem Zaffar,
Cabinet Member for Transport and Environment
Councillor Tristan Chatfield,
Cabinet Member for Finance and Resources

Relevant O&S Chairs: Councillor Liz Clements,
Chair, Sustainability and Transport Overview and Scrutiny Committee
Councillor Sir Albert Bore
Chair, Resources Overview and Scrutiny Committee

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| | | |
|---|---|---|
| Are specific wards affected? | <input type="checkbox"/> Yes | <input checked="" type="checkbox"/> No – All wards affected |
| If yes, name(s) of ward(s): N/A | | |
| Is this a key decision? | <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No |
| If relevant, add Forward Plan Reference: 006018/2018 | | |
| Is the decision eligible for call-in? | <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No |
| Does the report contain confidential or exempt information? | <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No |
| Appendix C: Private Appendix | | |
| Exempt information paragraph 3. Information relating to the financial or business affairs of any particular person (including the council). | | |

1 Executive Summary

- 1.1 The Council entered into the Highway Maintenance and Management PFI (HMMPFI) contract in June 2010 to ensure that there was extensive investment to rehabilitate its highway infrastructure and then, following this investment, to maintain the infrastructure thereafter until 2035.
- 1.2 The required investment has not taken place and is presently nearly four years beyond the required completion date. There is inconsistent and poor performance by the subcontractor - Amey LG (ALG) - and a reticence to improve. Disappointingly, the Council has been left with no option but to pursue matters through extensive dispute processes and litigation.
- 1.3 It is generally accepted by all parties to the contract that for matters to move forward, ALG must be replaced with a new subcontractor. To do so will require a managed release and handover to a new provider to be put in place, together with an appropriate settlement to rectify the liabilities ALG proposes to leave behind.
- 1.4 The terms of this managed exit are not yet agreed and are subject to commercial negotiation. However, this report seeks to establish the criteria for a settlement to be acceptable for the Council and enables Officers to agree settlement within parameters set by Cabinet. If an acceptable settlement can be agreed within those parameters, this will allow matters to move forward with obtaining a new provider and improvement in the condition of the city's roads, pavements and other highway infrastructure.

2 Recommendations

That cabinet:

- 2.1 Approves the Council entering into settlement agreement in respect of all disputes under the Highway Maintenance and Management PFI contract in accordance with the settlement criteria as set out in Appendix C (Private Appendix - C1) and delegates authority to the Director, Inclusive Growth, in conjunction with the Chief Finance Officer and in consultation with the Cabinet Members for Transport and Environment and Finance and Resources, to negotiate, finalise and agree a settlement (including all necessary agreements to facilitate this), subject to the settlement meeting the criteria set out in Appendix C (Private Appendix - C1);
- 2.2 Subject to an acceptable settlement being agreed in line with 2.1 above, delegates authority as follows:
 - 2.2.1 To the Assistant Director, Highways and Infrastructure to:
 - commence negotiation of commercial terms with Amey Birmingham Highways Ltd (the SPV) relating to its procurement of a replacement Operating Subcontractor, to be subject to approval under a further report to Cabinet and the approval of the Department for Transport;
 - take the actions described in paragraph 2.1 of Appendix C (Private Appendix) and

- put in place the sources of assurance set out in Appendix C (Private Appendix – C6);
- 2.2.2 To the Chief Finance Officer to take the actions described in paragraph 2.2 of Appendix C (Private Appendix); and
- 2.2.3 To the City Solicitor to execute, seal and complete all necessary agreements and documentation to give effect to the above recommendations; and
- 2.3 Notes the information contained within the Private Appendix regarding the Council's commercial position to support the above decisions.

3 Background

Contract purpose and structure

- 3.1 The City Council entered into the HMMPFI contract to improve the city's highway infrastructure and provide operational services on the highway network over the full 25-year contract term. The contract commenced on 7 June 2010 and included an initial five year 'core investment period' (CIP). It provides the Council with a £51.9m per annum Private Finance Initiative (PFI) grant from government to supplement the Council's own revenue budget for highway maintenance and management, which has been ring fenced for the 25 years duration of the contract.
- 3.2 The structure of the contract is shown in Appendix A. To qualify as a PFI contract, the contracting structure is designed to transfer risks of non-performance from the Council. The Council's contract is with Amey Birmingham Highways Ltd (ABHL), a 'special purpose vehicle' company that employs ALG (a subsidiary of Amey plc, providing highway maintenance and management services) as its main subcontractor to provide the services. ABHL thus transfers its risk of non-performance to ALG.

Disputes and issues

- 3.3 After an initial period of delivery, the Council began to identify concerns regarding the delivery of the contractual services, principally with ALG, although there have also been concerns with ABHL's management of ALG.
- 3.4 These concerns can be broadly summarised as follows:
- 3.4.1 *A failure to deliver the CIP works, principally on roads and pavements.* This has comprised many questionable investment decisions, including selection of the wrong roads and pavements for investment, not carrying out works to the full extent required on those roads and not carrying out surfacing refurbishment works with treatments of adequate longevity.
- 3.4.2 *Inconsistent and poor operational performance.* ALG has failed to provide the full range of operational services consistently to the standards required under the contract. This includes late and inadequate responses to urgent defects but also significant failures to fully and consistently carry out routine maintenance

activities to the appropriate extent and with the required standards of workmanship and professionalism.

- 3.4.3 *Resistance to accept its failures and address these in the interest of performing the services.* The Council has managed these problems fairly and appropriately using a full range of formal and informal contract management methods over a sustained period of time. It appears that ALG simply does not wish to accept the commercial risks it took in entering into this contract. It has consistently sought to argue and obfuscate in the face of clear facts and commercial logic, rather than work positively to address its contractual failings and improve performance. This negative approach has left the Council with no alternative but to take legal action in order to recover sums that were not due to ABHL and try and compel ABHL and ALG to comply with their contractual obligations.
- 3.5 The Council still has many disputes with ABHL and ALG, ranging from relatively small amounts to millions of pounds. The principal disputes have been those relating to the failure to deliver the CIP works on roads and pavements, which are of very high value and pervasively affect the Council's highway network. However, the disputes are by no means confined to this. There are many lower value disputes relating to failure to provide services, failures to complete agreed requirements of previous settlements and failures to address non-financial warning notices for breaches of contract relating to safety and provision of programmes.
- 3.6 The principal legal dispute under the contract commenced in 2014 and has been through adjudication (June 2015), the High Court (February 2016) and the Court of Appeal (January 2018). The Council won comprehensively at the Court of Appeal, with the Court commenting that ALG (through ABHL) had "*thought up an ingenious new interpretation of the contract, which would have the effect of reducing their workload*". The Supreme Court then refused ALG leave to appeal in July 2018, bringing an end to the dispute in the Council's favour.
- 3.7 The Council considers that the failure to deliver the CIP investment has compounded matters for ALG. Surfaces have received inadequate treatment, leading to extensive numbers of dangerous defects of increasing severity. At the same time, ALG's approach has become more unreasonable and argumentative as it has very clearly struggled to meet its contractual obligations within the limited financial means it has committed.
- 3.8 Extensive efforts have been made to resolve matters with ABHL and ALG. Discussions throughout 2015 led to a settlement in December 2015, which was an attempt by the Council to draw a line under previous difficulties and move forward. Unfortunately, ALG was found by a third party monitor to have substantively failed to meet its obligations under that settlement and further disputes have resulted. Further discussions in 2017 led to a small amount of investment but ultimately a full agreement on disputes could not be reached. ALG withdrew from discussions in January 2018 prior to the Court of Appeal hearing the investment dispute.
- 3.9 The outcomes of the Court of Appeal judgment were that:

- 3.9.1 ABHL was held to owe the Council £54.95m plus interest from overpayments, for which it has a consequent claim on ALG;
- 3.9.2 ABHL (and ALG on its behalf) was required to correct the way in which it planned investment on roads and pavements and to programme and deliver the necessary work (at its own cost, in addition to the overpayments above) to refurbish the Council's highway network.
- 3.10 ALG subsequently made a request for appeal to the Supreme Court. The Supreme Court's refusal to grant leave to appeal on 31 July 2018 effectively ended the legal process and prompted a shift in approach from Amey and from August 2018 it began to propose its exit from the HMMPFI contract. There is a general acceptance from all parties to the contract that this is now the only way forward. Since that time ALG has made three offers to ABHL to exit the contract and the Council has been working with all parties to achieve this exit in an acceptable manner. Those offers are described within Appendix C (Private Appendix).

Replacing ALG

- 3.11 The contract was procured to enable the Council to meet its statutory duties relating to maintenance of highway infrastructure, primarily under the Highways Act 1980 and the New Roads and Street Works Act 1991. It is therefore essential that there is continuity of service provision throughout any period of contractor replacement.
- 3.12 ALG is a subcontractor to ABHL. It has no direct relationship under the main contract to either the Council or project lenders. The process for replacing ALG as ABHL's subcontractor needs to complete a number of actions, as follows:
- 3.12.1 The *terms of ALG's release* need to be agreed, including the amount to be paid by ALG to ABHL in settlement of its contractual liabilities, when that money is paid and which liabilities are to be settled.
- 3.12.2 *Procurement of a replacement subcontractor by ABHL* needs to commence.
- 3.12.3 The process of *transition from ALG to a replacement* needs to be agreed, including a date of exit.
- 3.12.4 If a replacement subcontractor cannot be procured by ABHL for the remaining contractual term, *an interim means of providing the services* will need to be agreed. This will include agreeing how the services are provided during this period and to what standard.
- 3.12.5 *Capital investment works* will need to take place on roads and pavements in particular to ensure that a new subcontractor is not faced with an insurmountable backlog. These works need to be planned, designed and commissioned by ABHL.
- 3.13 The Council therefore needs to work with ABHL, project lenders and ALG to put in place a series of agreements that give effect to these requirements. The starting point in this process is agreeing the terms of ALG's release and the means by

which service provision is continued (3.12.1 to 3.12.5 above). That is the subject of this report.

- 3.14 Once ALG has been released and the terms for a replacement subcontractor known, the Council will be required to submit a revised business case to the Department for Transport for approval of continued PFI grant. This will be the subject of a further Cabinet report.

Service provision

- 3.15 Whilst ALG remains in contract, it is not presently considered to be providing services at a level near to meeting the contract requirements. ALG has provided token programmes of capital investment that effectively comprise the bare minimum of work it has to provide without failing to comply with statutory duties. The contract terms are being applied and as a consequence, appropriate financial deductions continue to be made for poor performance from the Council's payments due to ABHL.
- 3.16 Whilst ALG maintains that it is complying with the contract, this level of poor performance is unlikely to change substantially leading to ALG's release. It is expected that there will be two periods for operational services (i.e. non-capital investment services) following an agreement to release ALG:
- 3.16.1 A *Transitional Period*, between the completion of an agreement to release ALG and its release. During this, ALG will de-mobilise and hand over provision to a new, interim provider; and
- 3.16.2 An *Interim Period*, between the release of ALG and the commencement of a replacement subcontractor for the remainder of the contract term.
- 3.17 As ALG is providing services to meet statutory requirements, any agreement to its release must ensure that these services continue to be provided at a level that meets statutory requirements and does not create backlogs of maintenance. This will necessitate some minor changes to the contract specification for the Interim Period. Such changes are described within the Private Appendix together with the requirements for ancillary commercial arrangements.
- 3.18 In respect of capital investment, this will need to resume as soon as possible to ensure that the network does not continue to deteriorate unacceptably. ABHL will need to confirm its means of delivering this investment. To ensure the best commercial position for future re-procurement, investment priorities will need to be directed by condition, with the worst roads and pavements generally being addressed as a priority. To facilitate investment taking place as soon as possible this will need a degree of expedited approval by the Council.

4 Options considered and recommended proposal

- 4.1 In overall terms, addressing the issues described in section 3 above requires that disputes with ALG are resolved, capital investment in the Council's highway

network resumes and performance is improved to a consistent and satisfactory standard. The optimum position is that this continues in the framework of a PFI contract, whereby the PFI grant is retained to fund a re-procured project.

- 4.2 At this stage there are fundamentally two options. Either a settlement can be agreed that is on acceptable terms to the Council, or it cannot. In the event that it cannot, Appendix C (Private Appendix) sets out the Council's alternatives, which are part of the consideration of the commercial basis for this decision. They are detailed in section 4 of Appendix C (Private Appendix).
- 4.3 The decisions recommended in section 2 above facilitate steps towards a consensual settlement and managed replacement of ALG as subcontractor where the terms of such settlement are acceptable to the Council. This option keeps the main contractual arrangement between the Council and ABHL intact, whilst changing the subcontractor. It provides the means to agree a resolution of disputes and a way forward and ensures continued PFI grant funding from Government. This is therefore the recommended proposal.

5 Consultation

- 5.1 Officers from Legal and Governance Services, City Finance and Procurement have been involved in the preparation of this report. External legal advice has been obtained from DLA Piper.
- 5.2 Department for Transport (as the Council's sponsoring Government department for the project) has been consulted throughout discussions and is supportive of the Council's approach. The Department is supportive of the Council's approach and has given commitments to work with the Council in addressing the problems arising from performance under the contract.

6 Risk Management

- 6.1 Analysis of risks is contained within Appendix C (Private Appendix – section 5 and Appendix C5).

7 Compliance Issues:

7.1 How are the recommended decisions consistent with the City Council's priorities, plans and strategies?

- 7.1.1 The Council has adopted the *Council Plan 2018 to 2022*. This identifies five outcomes for the city, the first of which is "*Birmingham is an entrepreneurial city to learn, work and invest in.*" Priority 4 under this outcome is that "*We will develop our transport infrastructure, keep the city moving through walking, cycling and improved public transport.*"
- 7.1.2 This decision directly affects investment in and maintenance of the Council's 2,500km highway network and Council-owned infrastructure on it. Such investment will directly reduce the percentage of carriageways that should be

considered for structural maintenance; this is a measure for Outcome 1 / Priority 4 of the Council Plan.

- 7.1.3 Citizens' priorities also reflect that road and pavement repairs are the fourth highest priority in the city for citizens.

7.2 Legal Implications

- 7.2.1 The Council has a statutory duty to maintain highway infrastructure, primarily under the Highways Act 1980 and the New Roads and Street Works Act 1991.
- 7.2.2 Under s.111 of the Local Government Act 1972 the Council has power to do anything which is calculated to facilitate, or is conducive or incidental to, the discharge of any of its functions.
- 7.2.3 The information contained within Appendix C (Private Appendix) is considered exempt under Schedule 12A of the Local Government Act 1972, as it relates to the financial / business affairs of parties to the Highway Maintenance and Management PFI contract, including the Council.
- 7.2.4 Disclosure of the information within Appendix C would adversely affect the council's ability to negotiate the best value outcome in relation to the contract and disputes by disclosing its strategy to those with whom it is negotiating. It is therefore not in the public interest to make this information available publicly.

7.3 Financial Implications

- 7.3.1 The Council presently receives a PFI grant from government of £51.9m per annum in relation to this contract and funding mechanism. In addition, as part of its Full Business Case, it has agreed to ring fence and index its revenue budget prior to the contract for the provision of these services. For 2019-20 the Council's budget (including indexation) is £46.01m.
- 7.3.2 Any financial implications will be maintained within existing HMMPFI resources. Further details are provided in Appendix C (Private Appendix).
- 7.3.3 The City Council may seek to agree a commercial settlement in accordance with the terms set out in Appendix C (Private Appendix – C1, C2 and C3) and within existing portfolio resources.
- 7.3.4 Legal costs to finalise and progress such matters have been approved under the Council's Procurement Governance Arrangements process (2 February 2017).

7.4 Procurement Implications

- 7.4.1 There are no procurement implications arising directly from this report. The Council's contract with ABHL remains and the replacement of ALG is a matter for ABHL to conclude.

7.5 Human Resources Implications

- 7.5.1 Staff performing the services under the contract will have rights under the Transfer of Undertakings (Protection of Employment) Regulations 2006

(“TUPE”). This is anticipated to involve the transfer of staff from ALG to another provider as an interim arrangement and then potentially to a replacement Operating Subcontractor on appointment thereafter.

7.6 Public Sector Equality Duty

7.6.1 A copy of the initial equality assessment screening (reference EQUA296) is shown in Appendix B.

8 Appendices

8.1 A: Contract Structure

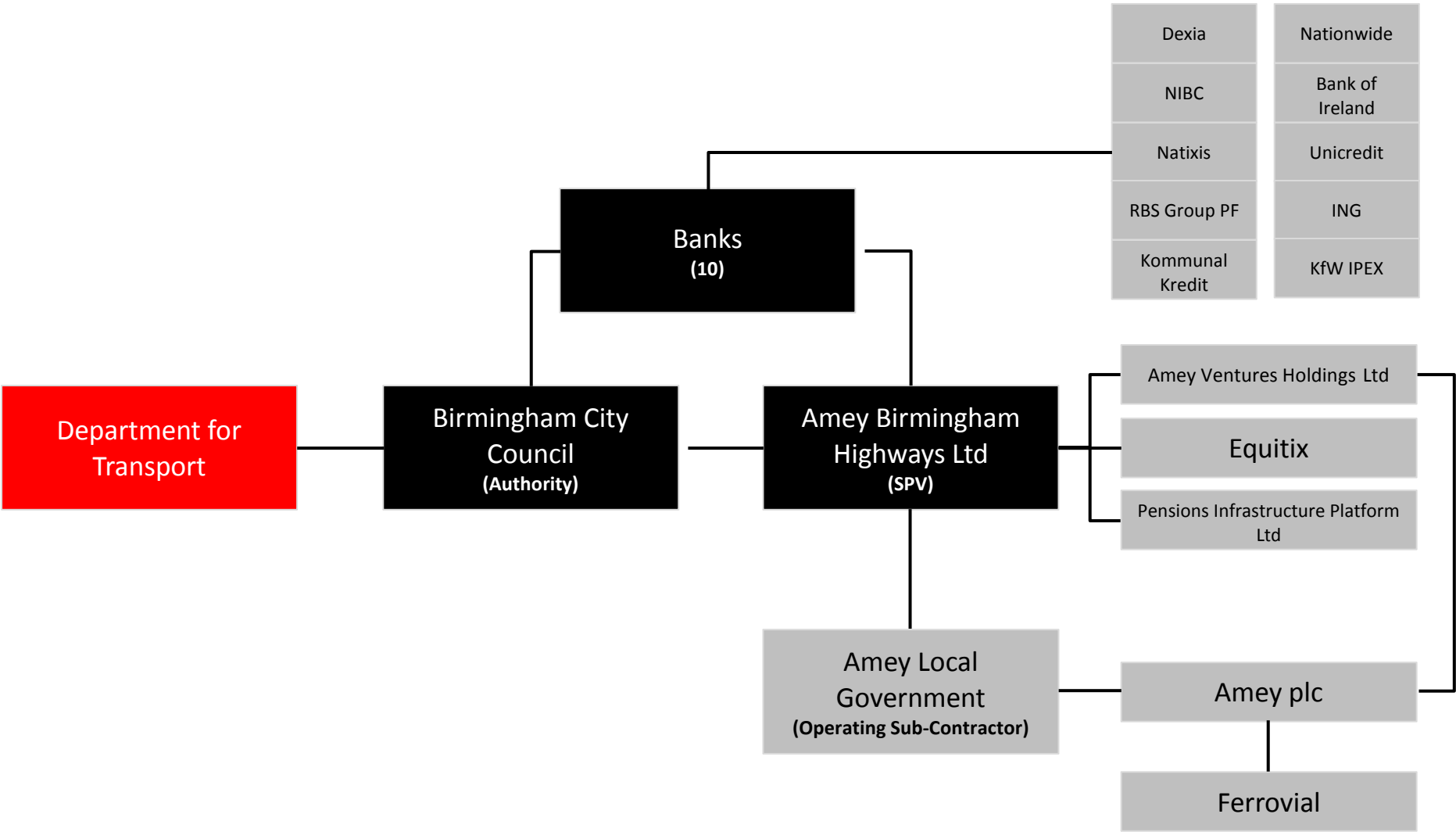
8.2 B: Equality Assessment

8.3 C: Private Appendix

9 Background Documents

9.1 Report of the Corporate Director, Economy to Cabinet, 31 July 2018 (public).

Appendix A



Appendix B

Equality Assessment

Equality Act 2010

The Executive must have due regard to the public sector equality duty when considering Council reports for decision.

The public sector equality duty is as follows:

- 1 The Council must, in the exercise of its functions, have due regard to the need to:
 - (a) eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by the Equality Act;
 - (b) advance equality of opportunity between persons who share a relevant protected characteristic and persons who do not share it;
 - (c) foster good relations between persons who share a relevant protected characteristic and persons who do not share it.
- 2 Having due regard to the need to advance equality of opportunity between persons who share a relevant protected characteristic and persons who do not share it involves having due regard, in particular, to the need to:
 - (a) remove or minimise disadvantages suffered by persons who share a relevant protected characteristic that are connected to that characteristic;
 - (b) take steps to meet the needs of persons who share a relevant protected characteristic that are different from the needs of persons who do not share it;
 - (c) encourage persons who share a relevant protected characteristic to participate in public life or in any other activity in which participation by such persons is disproportionately low.
- 3 The steps involved in meeting the needs of disabled persons that are different from the needs of persons who are not disabled include, in particular, steps to take account of disabled persons' disabilities.
- 4 Having due regard to the need to foster good relations between persons who share a relevant protected characteristic and persons who do not share it involves having due regard, in particular, to the need to:
 - (a) tackle prejudice, and
 - (b) promote understanding.
- 5 The relevant protected characteristics are:
 - (a) marriage & civil partnership
 - (b) age
 - (c) disability
 - (d) gender reassignment
 - (e) pregnancy and maternity
 - (f) race
 - (g) religion or belief
 - (h) sex
 - (i) sexual orientation

Equality Screening

The equality screening (reference EQUA295) follows.

| | |
|---|---|
| Title of proposed EIA | Highways Maintenance and Management PFI contract |
| Reference No | EQUA296 |
| EA is in support of | Amended Function |
| Review Frequency | Annually |
| Date of first review | 09/05/2020 |
| Directorate | Inclusive Growth |
| Division | Highways and Infrastructure |
| Service Area | Street Services Division |
| Responsible Officer(s) | ■ Jamie Davies |
| Quality Control Officer(s) | ■ Jenny Bent |
| Accountable Officer(s) | ■ Ravinder Sahota |
| Purpose of proposal | The Highways Maintenance and Management PFI contract delivers investment and maintenance of highways infrastructure to June 2035. This is a proposed decision regarding the commercial management contract. |
| Data sources | relevant research |
| Please include any other sources of data | |
| ASSESS THE POTENTIAL IMPACT AGAINST THE PROTECTED CHARACTERISTICS | |
| Protected characteristic: Age | Not Applicable |
| Age details: | There is no adverse impact on any of the protected groups and therefore this will not be applicable. |
| Protected characteristic: Disability | Not Applicable |
| Disability details: | There is no adverse impact on any of the protected groups and therefore this will not be applicable. |
| Protected characteristic: Gender | Not Applicable |
| Gender details: | There is no adverse impact on any of the protected groups and therefore this will not be applicable. |
| Protected characteristics: Gender Reassignment | Not Applicable |
| Gender reassignment details: | There is no adverse impact on any of the protected groups and therefore this will not be applicable. |

| | |
|--|--|
| Protected characteristics: Marriage and Civil Partnership | Not Applicable |
| Marriage and civil partnership details: | There is no adverse impact on any of the protected groups and therefore this will not be applicable. |
| Protected characteristics: Pregnancy and Maternity | Not Applicable |
| Pregnancy and maternity details: | There is no adverse impact on any of the protected groups and therefore this will not be applicable. |
| Protected characteristics: Race | Not Applicable |
| Race details: | There is no adverse impact on any of the protected groups and therefore this will not be applicable. |
| Protected characteristics: Religion or Beliefs | Not Applicable |
| Religion or beliefs details: | There is no adverse impact on any of the protected groups and therefore this will not be applicable. |
| Protected characteristics: Sexual Orientation | Not Applicable |
| Sexual orientation details: | There is no adverse impact on any of the protected groups and therefore this will not be applicable. |
| Please indicate any actions arising from completing this screening exercise. | Not applicable. |
| Please indicate whether a full impact assessment is recommended | NO |
| What data has been collected to facilitate the assessment of this policy/proposal? | |
| Consultation analysis | |
| Adverse impact on any people with protected characteristics. | |
| Could the policy/proposal be modified to reduce or eliminate any adverse impact? | |
| How will the effect(s) of this policy/proposal on equality be monitored? | |
| What data is required in the future? | |
| Are there any adverse impacts on any particular group(s) | No |
| If yes, please explain your reasons for going ahead. | |
| Initial equality impact assessment of your proposal | |
| Consulted People or Groups | |
| Informed People or Groups | |
| Summary and evidence of findings from your EIA | There is no adverse impact on any of the protected groups and therefore this will not be applicable. |

QUALITY CONTORL SECTION

Submit to the Quality Control Officer for reviewing?

No

Quality Control Officer comments

Decision by Quality Control Officer

Proceed for final approval

Submit draft to Accountable Officer?

No

Decision by Accountable Officer

Approve

Date approved / rejected by the Accountable Officer

09/05/2019


Reasons for approval or rejection


Please print and save a PDF copy for your records

Yes

Content Type: Item

Version: 27.0

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Close

Appendix C

Private Appendix