

Highway Maintenance and Management PFI Contract Risks

Briefing note for Audit Committee, 20 November 2018 (Public)

1. Introduction

- 1.1 The purpose of this briefing note is to explain to the committee:
- i. the current position regarding the council's Highway Maintenance and Management PFI contract;
 - ii. the council's objectives; and
 - iii. how the council manages risks relating to the contract.
- 1.2 For reference, throughout this note:
- i. "ABHL" refers to Amey Birmingham Highways Ltd, a Special Purpose Vehicle (SPV) with whom the council holds its Highway Maintenance and Management PFI contract.
 - ii. "ALG" refers to Amey Local Government or Amey LG, a division of Amey plc that is the subcontractor to ABHL and provides or procures the provision of the services under the council's Highway Maintenance and Management PFI contract.

2. Background

- 2.1 The most recent decisions by Cabinet relating to this issue were taken in July 2018. A detailed background to that point was provided in section 5 of that report (see Appendix 1 to this report).
- 2.2 Appendix 2 shows the relationship between different parties within the contract structure. This is also important in understanding the relevant relationships under the contract.
- 2.3 Members may also find the attached slide pack helpful in describing the basis and objectives of the contract.
- 2.4 Since July 2018, the following events have taken place:
- i. Amey LG has refused to pay the ~£55m + interest that it owes to ABHL and therefore to the council.
 - ii. The Supreme Court has refused Amey LG / ABHL leave to appeal against the Court of Appeal judgment on 30 July 2018.
 - iii. We have also demonstrated conclusively that (i) Amey has no right to retain this money and (ii) any Milestones that are certified will only apply from the date that they are certified (i.e. not retrospectively).
 - iv. Amey LG has also declined in our view to transparently provide information regarding the condition of our highway network. For several months we consider that it has been unable to demonstrate that it is complying with the order of the Court of Appeal in respect of this. They continue, with ABHL, to appear to seek to confuse what is required and what information has been provided.
 - v. Amey LG has refused to provide programmes to complete the investment that it is obliged to do. These would be derived in part from knowing the present condition of the network. Programmes have been provided but these contain no meaningful attempt to provide the work that they are obliged to perform.
 - vi. Lenders have placed the Holding Company for the SPV in administration. This is a technical administration; the SPV remains solvent and able to trade. They have appointed two administrators and they have appointed two new board members,

replacing the two Amey board members. This should enable the Board to take decisions in the interests of the SPV as a company, without those decisions being directly influenced by their consequences for Amey, who is in any event only one of three shareholders.

2.5 Unfortunately, the council has had no alternative to pursue matters in this way:

- i. Fundamentally, Amey LG / ABHL have failed to provide for a substantial part of the investment due under the contract. To not pursue this matter would be to accept that non-provision and fail to obtain a substantial deliverable. That would not be value for the public purse (and could have implications for our PFI grant).
- ii. Despite the current position, the council has managed this contract appropriately and well. In the early years we sought extensively to work with Amey LG to help them improve their performance. They have proven to be unwilling or unable to deliver the required investment and operational performance or delivering requirements of previous settlements. This has necessitated more robust action and this has been escalated proportionately over a considerable period of time to arrive at the current position.
- iii. We consider that Amey LG in particular has demonstrated that they cannot be relied upon to substantively and transparently deliver the requirements of previous settlements.

2.6 We have insisted that in the absence of any other agreement, we expect:

- i. Amey LG and ABHL to comply with the order of the Court of Appeal and their contractual obligations;
- ii. Amey LG to pay the money that they owe to ABHL and ABHL to pay this to the council; and
- iii. Amey LG to continue with their contractual obligations to maintain the network and invest in it.

2.7 Whilst we agree that there is ultimately no long term future for Amey on this contract, to discuss the terms of their exit before Amey is complying with the contract requirements would not be an appropriate commercial position for the council.

3. Our objectives

3.1 The council's objectives remain consistent. These are to ensure best value for the public purse by:

- i. Obtaining the investment for which the Council is paying, i.e. the investment in the network, but also future programmed and routine maintenance;
- ii. Retaining the capacity and financial support from central government to deliver the services in the future (i.e. protect the PFI grant);
- iii. Ensuring that we manage the contract effectively and only pay for what we receive and ensure ABHL / ALG is properly dis-incentivised from underperforming;
- iv. Developing a way forward that will enable the Council to have confidence in future service delivery, which stabilises performance, minimises safety risk, cost implications and reputational risks to the Council and maintains acceptable standards of service delivery.

4. The role of Audit Committee in this matter

4.1 As the Audit Committee you have oversight of how the council's actions are managing the risks to the council in respect of this complex issue. As stated in the Risk Management Toolkit, this is *"to provide independent assurance to the Council in relation to internal control, risk management and governance."*

- 4.2 These risks are principally captured within the Corporate Risk Register, specifically Risk 6. This describes the overall management of the risks associated with the council not receiving what it is / has been paying for through the contract.
- 4.3 This is however a much more complex matter than can be captured in one risk register entry alone. There are therefore a number of more detailed risks and permutations that are managed by the council's client team on a day to day basis. These may transpire as specific risks in the future. Due to the nature of the information, these are appropriately detailed in the private part of this report.

Domenic de Bechi

PFI Contract Manager

domenic.de.bechi@birmingham.gov.uk

Appendix 1: Background

Extracted from section 5 of the report to Cabinet, 31 July 2018 (Public).

Background to the current position

- 5.1 The HMMPFI contract commenced on 7 June 2010 and included an initial five year 'core investment period' (CIP) to improve the city's highway infrastructure and provide operational services on the highway network over the full 25-year contract term. It provides the Council with a £51.9m per annum 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. The Council's contract is with Amey Birmingham Highways Ltd (ABHL), a 'special purpose vehicle' company that employs Amey LG (ALG – a subsidiary of Amey plc providing highway maintenance and management services) as its main subcontractor to provide the services.
- 5.2 After an initial period of delivery, the Council began to identify concerns regarding a range of issues with ABHL. These issues included questionable investment decisions, quality of workmanship and performance. The Council has many disputes with ABHL and ALG, ranging from relatively small amounts to tens of £millions. Further detail on ongoing contractual disputes pursued under the HMMPFI contract is contained in the Private Report.
- 5.3 Officers have made extensive efforts to resolve these disputes with ABHL. Throughout 2017, discussions took place with senior managers in ALG and Amey plc towards a comprehensive settlement of all disputes. The timing at that moment, following the September 2016 High Court judgment that was nominally in favour of ABHL / ALG, was advantageous for ALG and Amey plc.
- 5.4 From discussions in 2017 an interim agreement was approved by Cabinet in July 2017 and signed in September 2017. This provided a degree of investment on roads and pavements in return for contractual relief to ABHL / ALG to enable them to address performance issues. Cabinet considered and approved the terms for a potential full settlement on 12 December 2017. However, this settlement was not completed as those terms could not be agreed with ALG and its parent company Amey plc.
- 5.5 The Court of Appeal unanimously determined one of the two significant investment disputes (the Project Network Model) conclusively in the Council's favour in February 2018. It described ABHL / ALG's actions as an "*ingenious interpretation of the contract*" and went on to state that parties in a long term contract such as this should not be seeking to "*disrupt to the project to maximise [their] own gain*".
- 5.6 The effect of the Court of Appeal's judgment and subsequent Order dated 22 February 2018 was that:
- 5.7 ABHL is now required to re-calculate the condition of roads and footways and to provide programmes of investment work to rehabilitate it correctly; and
- 5.8 The Court of Appeal judgment overturns the High Court judgment, meaning that the Council (i) is no longer obliged to pay ABHL as though investment work was completed after May 2013 and (ii) is entitled to recover the overpayments that result (£54.95m) together with accrued interest. This has also reduced future monthly payments to ABHL by ~£1.3m each month.
- 5.9 The current position on implementing the judgment is that ABHL / ALG (despite additional pressure, including litigation):
- 5.10 have not completed the investment required under the contract, and in fact have neither provided details of the condition of roads and footways, nor provided programmes to do this;

- 5.11 have not repaid the significant sums of money (in excess of £55m) owed to the Council; and
- 5.12 have continued not performing the contract requirements (in addition to providing the investment required by the court decision), which has resulted in the Council withholding ~£42m from payments in relation to non-performance (up to and including the June 2018 Monthly Payment).

Appendix 2: Contract Structure

