

BIRMINGHAM CITY COUNCIL

PUBLIC REPORT

Report to: CABINET
Report of: CORPORATE DIRECTOR, ECONOMY
Date of Decision: 31 JULY 2018
SUBJECT: HIGHWAYS MAINTENANCE AND MANAGEMENT PFI CONTRACT
Key Decision: Yes
Relevant Forward Plan Ref: 005137/2018
If not in the Forward Plan: Chief Executive approved ☐
(please "X" box) O&S Chair approved ☐
Relevant Cabinet Members: Councillor Waseem Zaffar, Transport and Environment
Councillor Brett O'Reilly, 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
Wards affected: All

1. Purpose of report:

- 1.1 To update Cabinet on the current position regarding the Highway Maintenance and Management PFI (HMMPFI) contract disputes and performance management and to obtain approvals to support delivery of the Council's objectives regarding its future management and provide assurance for the Council.

2. Decisions recommended:

That the Cabinet:

- 2.1 Notes the current position set out in this report;
- 2.2 Approves the commencement of single contractor negotiations by the Assistant Director, Highways and Infrastructure with DLA Piper for the provision of advisory and advocacy services in relation to disputes under and advice relating to the Highways Maintenance and Management PFI Contract (described in Appendix 3 to the Public Report); and
- 2.3 Approves the commencement of single contractor negotiations by the Assistant Director, Highways and Infrastructure with Jacobs for the provision of Third Party Monitoring services in relation to disputes under and advice relating to the Highways Maintenance and Management PFI Contract (described in Appendix 4 to the Public Report).

Lead Contact Officer(s): Kevin Hicks, Assistant Director, Highways and Infrastructure
Telephone No: 0121 675 3748
E-mail address: kevin.hicks@birmingham.gov.uk

3. Consultation:

3.1 Internal

- 3.1.1 Officers from Legal and Governance Services, City Finance and Procurement have been involved in the preparation of this report.

3.2 External

- 3.2.1 External specialist legal advice has been provided by DLA Piper.

4. Compliance Issues:

4.1 Are the recommended decision(s) consistent with the Council's Policies, Plans and Strategies?

4.1.1 The Council has adopted the *Council Plan, 2018+*, which identifies four key drivers of change in Birmingham (Children, Housing, Jobs and Skills and Health). This decision supports the vision as follows:

- *Jobs and Skills: Investment in infrastructure and improved connectivity.* This decision directly affects investment in and maintenance of the Council's 2,500km highway network and Council-owned infrastructure on it.

4.2 Financial implications - will decisions be carried out within existing finances and resources?

4.2.1 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.

4.2.2 Any financial implications will be maintained within existing HMMPFI resources. Further details are provided in the Private Report.

4.2.3 The City Council may seek to agree a commercial settlement in accordance with the terms set out in the Private Report and within existing portfolio resources. Legal costs to finalise and progress such matters have been approved under the Council's Procurement Governance Arrangements process (2 February 2017).

4.3 Legal implications

4.3.1 The HMMPFI 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.

4.4 Public Sector Equality Duty

4.4.1 A copy of the Equality Act 2010 – Public Sector Duty statement is set out in Appendix 1, together with the initial equality assessment screening (reference EA002825 – see Appendix 2).

5. Relevant background / chronology of key events

Background to 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:
- 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
 - 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.
- 5.7 The current position on implementing the judgment is that ABHL / ALG (despite additional pressure, including litigation):
- 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;
 - have not repaid the significant sums of money (in excess of £55m) owed to the Council; and
 - 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).

The Council's objectives in relation to this contract

- 5.8 The Council's objectives through this protracted legal process have consistently been to ensure best value for the public purse by:
- *Obtaining the investment for which the Council is paying*, i.e. the investment in the network, but also future programmed and routine maintenance;
 - *Retaining the capacity and financial support from central government* to deliver the services in the future (i.e. protect the PFI grant);
 - *Ensuring that we manage the contract effectively and only pay for what we receive* and ensure ABHL / ALG is properly dis-incentivised from underperforming;
 - *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.

Proposed way forward

- 5.9 ALG has failed to perform the contract services over a sustained period of time and importantly failed to provide the appropriate reassurance that they can and will carry out the required investment to meet their contractual obligations and comply with the court order. Consequently, their continuing as the subcontractor appears an increasingly untenable position.
- 5.10 The Council therefore has no alternative but to review how this matter can be taken forward with all parties to the contract.

Other actions necessary to support the Council's position

- 5.11 There are further actions that the Council needs to take now to support its appraisal and to ensure continued management of the contract in the interim. These comprise, continuation of provision of legal support / advocacy and the appointment of a Third Party Monitor.

6. Evaluation of alternative options:

The alternative options relating to the decisions in this Public Report are as follows.

- 6.1 *Undertake a full tendering process for dispute resolution and advocacy services.* This would take a significant period of time, causing considerable delay. In the event that another contractor was considered better able to provide these services, then there would also be a period of familiarisation. Any gap in continuity in providing these services poses an unacceptable risk to the Council's position. DLA Piper has worked with the Council on disputes since 2014, has a successful record and is in a unique position with regard to being able to provide these services and ensuring continuity.
- 6.2 *Undertake a full tendering process for Third Party Monitoring services.* This would again delay matters, which would pose an unacceptable risk to the Council's position. Jacobs has worked previously as the Third Party Monitor from August 2016 to January 2018, providing the services well and is in an almost unique position that it will be able to commence provision of these services at minimal notice.

7. Reasons for Decisions:

- 7.1 These decisions will support the Council's ongoing and future management of the HMMPFI contract in delivering its objectives and obtaining the necessary levels of assurance.

Signatures:

Date:

Councillor Waseem Zaffar
Cabinet Member for Transport and
Environment

Councillor Brett O'Reilly
Cabinet Member for Finance and
Resources

Waheed Nazir,

List of Background Documents used to compile this Report:

- Relevant Officer's file(s) on the matter, save for confidential documents.

List of Appendices accompanying this Report:

1. Equality Act, 2010
2. Initial Equality Assessment Screening
3. Highways Maintenance and Management PFI Contract: Dispute Support
4. Highway Maintenance and Management PFI Contract: Third Party Monitor services

APPENDIX 1: 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

APPENDIX 2: INITIAL EQUALITY ASSESSMENT SCREENING

APPENDIX 3: HIGHWAYS MAINTENANCE AND MANAGEMENT PFI CONTRACT: DISPUTE SUPPORT

This appendix details the proposed scope, reason and strategy to this procurement. The proposed commercial terms are described in Appendix 4 to the Public Report.

Background

Since 2014 the Council has procured external advisory and advocacy services in relation to the Highways Maintenance and Management PFI. These services supplement the advice from the Council's own Legal Services department, but also provides essential capacity and enable the Council to access specialist advice, such as advocacy (e.g. counsel for disputes) and specialist advice relating to PFI projects and contracts (legal, financial and technical). This includes specialist advice relating to the structure of financing mechanisms, procurement and technical project advice.

The present appointment of DLA Piper formally concluded on 30 June 2018. For the reasons below, it is essential to the successful conduct of disputes that this is extended and it is proposed to do this via a Single Contractor Negotiation.

Services required

1. To provide advice on strategic and tactical approach to disputes and contract management in support of the Council's objectives.
2. To procure advocacy for disputes.
3. To provide and / or procure advice, including specialist finance, procurement and technical advice, including to government departments.
4. To draft and prepare legal documentation in respect of matters subject to the advice above.

Procurement strategy

Authority is sought under Standing Order 5.2 to approve that the Assistant Director, Highways and Infrastructure conducts single contractor negotiations with DLA Piper for the provision of advisory and advocacy services in relation to disputes under and advice relating to the Highways Maintenance and Management PFI Contract.

It is important that this continuity is maintained until the contract is in a stable position, upon which the requirement can be reviewed. A period of three years (from 1 July 2018 to 30 June 2021) has been identified for this.

The contract will be managed by the Highways and Infrastructure service, with advice from Legal Services.

Reasons for a Single Contractor Negotiation

The reasons for a Single Contractor Negotiation are as follows:

- i. The Council is involved in extensive and complex disputes with ABHL and ALG. It is essential to success that there is continuity in the conduct of those disputes. Failure to do so would certainly delay dealing with matters and could produce an adverse outcome to disputes.
- ii. The DLA Piper team includes projects lawyers that were involved in the procurement of the contract. They have an extensive understanding of the commercial basis and construction of the contract that is unique.
- iii. DLA Piper (and the advocates it has selected) has successfully dealt with previous disputes, including the Project Network Model and also performance disputes. These have resulted in the Council confirming entitlement to over £60m of disputed amounts.

Its litigators have a good track record for the Council thus far and a detailed understanding of the disputes in which the Council is engaged.

- iv. Employing DLA Piper should be expected to save significantly compared to the start-up and familiarisation costs of a new legal advisor.
- v. DLA Piper already provides significantly discounted rates to the Council, particularly for partner level support. On the basis that the favourable commercial arrangement is at least maintained, this will enable the Council to continue to benefit from these discounted rates.

APPENDIX 4: HIGHWAY MAINTENANCE AND MANAGEMENT PFI CONTRACT: THIRD PARTY MONITOR SERVICES

Introduction

The right to appoint a Third Party Monitor is available to the Council under the contract as a specific remedy for failures by ABHL to monitor its performance of the services. Under the 2015 Settlement Agreement the Council previously appointed Jacobs as a Third Party Monitor to monitor specific requirements of the Settlement Agreement. Under the terms of the contract a Third Party Monitor is paid for by the Service Provider.

Given the fundamental issues with ABHL and ALG's performance of self-monitoring required under the contract, use of this remedy is essential to support the Council obtaining appropriate assurance of receiving the services for which it is paying.

On 8 June 2018 the Council notified ABHL of its concerns regarding the condition of the highway network and the lack of information regarding the works necessary to rectify this. This is a significant contractual step in that it gives notice of the Council's dissatisfaction with ABHL / ALG's self-monitoring. The Council advised its intention to appoint a Third Party Monitor to:

- i. Monitor and audit the services;
- ii. Audit Service Provider and subcontractor records and information to establish the current condition of the Project Network; and
- iii. Monitor and audit ABHL and ALG's monitoring processes.

Jacobs undertook the role of Third Party Monitor from August 2016 to January 2018. It is proposed to undertake a single contractor negotiation with Jacobs and, subject to agreeing terms within the parameters described within Appendix 5 to the Private Report, to award a contract to commence as soon as possible (potentially August 2018). The monitoring will continue until such time that there is sufficient assurance that ABHL is performing its obligations satisfactorily.

Services required

1. To conduct audits, monitoring, surveys and inspections of ABHL's / ALG's performance of contract requirements at the direction of the Council's client function. Such audits, monitoring, surveys and inspections will span the range of activities for which the Council is entitled to:
 - a. undertake Authority monitoring of maintenance obligations; and / or
 - b. appoint a Third Party Monitorunder the Highway Maintenance and Management PFI contract.
2. To record the outcomes of audits, monitoring, surveys and inspections and provide updates on progress.
3. To support the Council in demonstrating non-compliance by ABHL / ALG and specifying the work required to address it.

Procurement strategy

Authority is sought under Standing Order 5.2 to approve that the Assistant Director, Highways and Infrastructure conducts single contractor negotiations with Jacobs for Third Party Monitor services relating to the Highways Maintenance and Management PFI Contract.

Reasons for a Single Contractor Negotiation

The reasons for a Single Contractor Negotiation are as follows:

- i. It is essential to establishing the condition of the highway network that this work take place as soon as possible.
- ii. Jacobs already has the expertise and knowledge of the contract and use of contract systems such as the Management Information System. Whilst other contractors may be in a position to ultimately provide similar services, Jacobs is considered to be in a better position to do so sooner.
- iii. Employing Jacobs can be expected to save upon start-up and familiarisation costs of a new contractor. It is also considered to be of lower risk than employing another, new contractor, in that they have already demonstrated that they can perform this role successfully.