

Mitigations to Protect the Project in the Event of Contractor Failure

Edinburgh Tram – York Place to Newhaven

City of Edinburgh Council

1 Introduction

Following the recent liquidation of Carillion plc and due to the risk inherent in the construction industry, this paper sets out possible protections that it is recommended are put in place to protect the Council in the event of contractor failure.

If the I&S and/or the SPC contractor on the tram project were to fail, the consequences could include:

- Reputational Damage
- Unsafe work site
- Unpaid subcontractors refusing to work
- Unrectified defects
- Traffic management chaos
- Delays to programme
- Significant cost overruns
- No cover for latent defects

The consequences could also include difficulty in procuring a replacement contractor. While the EU procurement directives permit awarding a contract via negotiation without prior advertising in limited circumstances, these are very narrowly defined, and there is no such circumstance which applies in this case. The only potentially relevant derogation is “in so far as is strictly necessary where, for reasons of extreme urgency brought about by events unforeseeable by the contracting entity, the time limits laid down for open procedures, restricted procedures and negotiated procedures with prior call for competition cannot be complied with”. However, it would be extremely hard to argue that the event of contractor insolvency is unforeseeable.

If we had to run a new tender competition, then we would have to follow the whole formal procurement process again, including publishing a new OJEU notice, which would take at least eight to nine months.

While it is impossible to fully mitigate against these consequences, even taking account of the risk contingency, there are a number of other financial, contractual and operational measures that can be put in place to reduce the impact of this risk.

2 Financial and Contractual Protections

The project’s commercial strategy is to protect the Council from risks it is unable to manage. The following protections are built into proposed contractual and financial arrangements:

Regular financial checks – Contractors will undergo financial checks during procurement and the project will only contract with organisations that meet the Council’s criteria for a high-risk contract of this size. However, these checks are based on historic data and can rapidly become out of date. To counteract this, desktop checks will be performed at six monthly intervals during the contract so that the Council can put contingency plans in place which will

include convening a meeting with the contractor's senior management to discuss any concerns.

Consideration is also being given to including financial distress provisions in the contracts obliging the contractor to provide early warnings.

Performance bond – The draft contracts require contractors put in place a performance bond for between 10-20% of contract value. This would be paid out to the Council in the event of contractor failure, and can be used to help offset additional costs associated with re-procurement, inflation and defects remediation

Parent Company Guarantee – Where the contractor is not the parent company itself, then a parent company guarantee is required. This means that if the subsidiary company fails, the parent will be obliged to undertake the subsidiary's obligations. This measure gives no protection if the ultimate parent fails.

Joint & Several Liability – With regards to the I&S contract any formally constituted joint venture will be joint and severally liable, this is a requirement set out in the I&S contract. In the event of one member of the joint venture becoming insolvent, the other joint venture members would be obliged to complete the works at no additional cost to the Council. It should be noted that bidders may not form joint ventures and may rely on sub-contract arrangements between the key participants.

Collateral warranties – The contract requires the key subcontractors to provide collateral warranties, enabling the Council to step in and directly manage all key subcontracts.

Insurance – The OCIP includes cover for delay in start up, which would help the Council pay for the borrowing costs it would incur prior to the eventual opening of the tram line. In addition, as the Council would be controlling the policy, claims relating to the contractor would continue to be met, avoiding further reputational damage.

Project Bank Account – The senior management team is considering the use of a project bank account to make payments. This enables the Council to pay subcontractors directly, rather than paying them through the main contractor. This means that if the main contractor does go into administration, named subcontractors under the project bank account arrangement will have already been paid. A separate paper on this agenda assesses the potential benefits of using a project bank account.

3 Project Management Protections

In addition to the contractual protections, the project team needs to be in a position to mobilise quickly in order to directly manage contracts while reprocurring a replacement contractor and managing stakeholder expectations. The following project management protections will be put in place:

Large experienced client team – The client team required to deliver this project will be substantial, with extensive experience in delivering large scale infrastructure projects including key individuals from the recovery phase of the Airport to York Place tram project. This experience will allow the client to take all required actions including instructing traffic management works, making safe the site and reprocurring another contractor to complete the works with minimal disruption and programme impacts. The experienced client team will

have the ability to take a hand on approach to delivery of the project and take control of key subcontractors when required. While on a smaller scale, these are the same actions and issues that the client's team managed to undertake in order to maintain progress on Leith Programme Phase 4 following the administration of the principle contractor for that project.

Contracting Strategy – through the existing contracting strategy the Council would have either an SPC contractor or the Infrastructure & Systems contractor on site. In such a circumstance the Council would utilise the remaining contractor to make the site is safe, maintain safe and operational traffic management and continue works where possible to mitigate delays.

Procurement – A number of measures will be put in place to streamline the process for procuring a replacement contractor.

An “Award to Runner-Up” clause will be included in the Invitation to Tender, reserving the right for the Council to make a direct award to the next ranked tenderer in the event of contractor failure. This should allow the award of a new contract in the shortest possible timescale, but this is still likely to take a number of months in negotiations and contractor mobilisation.

There is a risk that the runner-up would seek to materially revise their tender, particularly in the knowledge of the events that led to the original contractor failing. Any such renegotiation could rule out the chance of a direct award. In these circumstances, the Council could avail of the national SCAPE framework agreement for general civil works to directly award a contract. Again, this is likely to take a number of months in negotiations and contractor mobilisation.

To further shorten the re-procurement process, tender documents could be prepared in advance to the extent possible.

Stakeholder Engagement - A client-first approach, where the Council remains ultimately responsible for the overall management and delivery of this portion of the project is being considered. This would ensure consistency in messaging, control over responses to contractor failure and an ability to seamlessly maintain communication and relations with the community and stakeholders.

Communications: A detailed communications protocol will form part of the contract award to the successful contractor and this will include contingency communications. In the event of contractor failure, and as lead on all strategic communications relating the project, the Council will take a proactive communications approach through all mediums available detailing what plans would be put in place to mitigate and resolve the situation. This messaging would be consistent with that communicated through the stakeholder engagement process outlined above.