

# Scoping exercise for 'Collaborative Contracting Strategy Toolkit'



### Background and context

The highways maintenance industry is about to embark on a period of unprecedented activity. Although revenue budgets may well come under increasing pressure, this is only part of the picture. It would appear that capital funding for local highway authorities will remain buoyant or even increase, and the planned increase in activity within Highways England is significant. These two factors combined will most likely change the dynamics of the market in the short to medium term.

There is undoubtedly going to be an issue with regard to capacity, certainly resources with the right skills and experience. Even now we are seeing early symptoms of this whereby;

- Contractors, whilst willing to stand by their original commitments, are reluctant to extend these contracts;
- Contractors are beginning to shift their focus to clients with whom they can generate higher margins in a non-confrontational environment;
- Sub-contractors and suppliers are beginning to shift their business to places where they can secure a fair return without incurring contractual risk;
- Salary costs, particularly for commercial personnel are on the increase and both clients and contractors are beginning to struggle to retain good staff.

So, those contracting arrangements that lend themselves to poor tender documentation, inappropriate partner selection based on lowest price, senior staff being tied up in relentless arguments over commercial issues rather than focusing on service delivery, and confrontational behaviours at all levels will most likely be shunned by the industry going forward.

The primary goal of the Toolkit recommended as part of this scoping document is to provide guidance and mechanisms to avoid such contracting arrangements and create an environment whereby the focus of all parties is on delivering customer value through operational effectiveness and efficiency.

### Methodology

The first challenge as part of this scoping exercise was to identify the key issues that contribute to the environment described above.

The HTMA (Procurement Working Group) has identified a number of these causes in their document 'Obtaining Best Value from Constrained Budgets'. As part of this scoping exercise further consultation has taken place through the creation of a Steering Group consisting of leading figures from within our industry representing client and contractor;

- Steve Kent (chair) – Board member HMEP
- Geoff Allister – Non Exec HTMA and Board member HMEP (consultee only)
- Matt Sweeting – Divisional Director Highways Agency and Board member HMEP
- Dave Wright – MD EM Highways
- Bill Taylor – MD Ringway
- Andy Rowley – Director LafargeTarmac
- Andy Best – Head LoHAC Contract Management Team TfL and ADEPT representative
- David Farquhar – Assistant Director Northamptonshire and HMEP Challenge Group member
- Martin Duffy and Jim Towey – appointed consultants for this work

This Steering Group identified a number of additional issues from their experiences on current contracts across the UK, and these have also been included in this scoping exercise.

Each of the issues were analysed in terms of their cause and effect, and a potential outline solution identified. This work was then reviewed by the Steering Group and their input taken on board to produce this final document.



### Scope

Many of the other HMEP products are associated with improving the efficiency of the way in which work is carried out under current contracting arrangements. However, there is another equally important angle to consider – are those current contracting arrangements adequate? Over the past few years our industry has been struggling with a number of key issues which adversely affect the quality of service delivered in highways maintenance as a result of these contracting arrangements. There is no doubt that these issues are constraining best value and potentially negating the benefits from the good work being done elsewhere by HMEP on efficiency improvements.

The implications of not addressing these issues are deep-rooted. Firstly, they heavily influence tender pricing strategies where the prices submitted do not directly reflect the actual cost of service delivery. This lack of clarity and consistency may lead to difference in interpretation by contractors resulting in wide variances of tender prices submitted. This can effectively be a barrier to entry to some contractors, which may further prevent clients receiving the optimum tender price. Disputes often arise involving considerable staff time and external consultant fees, all of which diverts money from being spent on delivery.

This scoping exercise covers the following;

- Identification of key industry issues
- Analysis of those issues segmented into;
  - Cause
  - Effect
  - Potential outline solution (to form the basis of the Toolkit in phase 2 of this work)
  - Linkage back to the key issue
- Structure and governance for the future development of the Toolkit

The output of this work is targeted at local highway authority contracts. It is recognised that there is a wide spectrum of local highway authorities whose needs differ, and it is important that the Toolkit supports the requirements of the smaller authorities and their service delivery arrangements whilst also supporting the larger authorities with more complex arrangements.

The strategy adopted is not necessarily as a 'fix all' dispute resolution guide, but primarily as an 'avoidance' mechanism to:

1. Ensure that the tender documents are prepared in such a manner as to avoid ambiguity and the potential for 'strategic pricing' that could result in commercial argument/tension during the life of the contract;
2. Ensure selection of the right contractor – to highlight areas where the potential for commercial argument/tension exists and ensure that client tender modelling/comparison mechanisms identify these such that informed choices may be made about the suitability of tenders;
3. Highlight opportunities for clients to develop/enhance service delivery by adopting more sophisticated techniques such as replacement of schedule of rates, sharing of benefits from innovation etc.;
4. Highlight the importance of the impact that behavior has on results, and how to assess suitability of potential contractors through cultural alignment in order to identify the right match.

A conservative estimate of the benefits anticipated from the Toolkit will be in excess of 5% of the cost to clients and include;

1. Avoidance of dispute – there is anecdotal evidence about some traditional contracts incurring up to 30% cost overruns. Obviously this would not apply to every contract. Assuming in aggregate that only 1 in 10 contracts suffer such an overrun this would equate to 3% across the board which could be saved by addressing the issues outlined in this document. A further 1% would result from external fees representing a total of 4%.
2. There will also be savings in the following areas:
  - Reduction in pricing of risks at tender stage due to uncertainty/ambiguity in pricing requirements
  - Reduction in contractor tendering cost due to removal of strategic pricing – there is significant senior management cost in deliberating and implementing pricing strategies
  - Reduction in contractor tendering cost due to less onerous/more focused schedule of rates/activities pricing requirements.

A conservative estimate of these costs is 1% of final out-turn cost.



3. A greater understanding of the relationship between cost and price.
4. Improved contractual relationships by adopting a formal collaborative contracting strategy.
5. Less ambiguity and greater clarity of the contracting arrangements between clients and contractors will allow greater opportunities for true 'back-to-back' relationships between contractors and their supply chains.
6. Quicker procurement timescales, benefitting both clients and contractors.

## Section 1 – Key industry issues

The following represents a summary of some of the key issues that our industry faces both pre and post tender that have the potential to result in significant additional cost, poor value for money, waste and use of resource focused on dispute resolution at the expense of working to deliver customer outcomes;

### Part A - Pre-tender

1. Poorly drafted OJEU Notices can tend to constrain post tender development of the contract;
2. Effectiveness of procurement procedure – appropriateness for accurate partner selection;
3. Inappropriate price/quality splits leading to uneconomic bids for clients or financially unsustainable tenders;
4. Structure of quality submissions that allow tenderers to over-promise through statements that are very often contractually unenforceable but nevertheless attract high marks during tender assessments, which in turn can compensate for high prices. Inappropriate quality assessment criteria leads to wrong partner selection;
5. Contract term – inappropriate contract durations can reduce potential opportunities for mutual commercial benefit;
6. Insufficient or incorrect information made available at tender stage resulting in;
  - Inappropriate risk pricing
  - Strategic pricing – tenderers being silent on and taking advantage of any inconsistencies and ambiguities in the tender documentation i.e. loading and de-loading of rates and moving money across the bid to either generate future additional profit or cash flow
  - Pricing based on assumptions
  - Inappropriate risk transfer around TUPE and pensions
7. Lack of robust tender assessment models potentially resulting in acceptance of bids that do not reflect the lowest outturn cost. This is very often due to prices being obtained and compared at tender stage that bears little resemblance to the work that will ultimately be carried out;
8. Lack of opportunity for tenderers to introduce and price innovative solutions at tender stage that may provide cost reduction or better value for clients;

9. Efficiency discounts - unsuitable discount mechanisms built into the contract;
10. Mobilisation – lack of transparency on pricing;
11. Lack of robustness of incentivisation/reward mechanisms built into the contract;
12. Bid team doesn't follow through to delivery resulting in a lack of a common understanding concerning quality promises;
13. Behaviours – lack of robust requirements and measurement in contracts in relation to the desired behaviours.

#### Part B - Post-tender

1. Contractors focus on activities with higher margin despite network needs. Service levels reduced in areas that attract unprofitable rates. Clients 'cherry pick' rates that make the overall service unsustainable from the contractor's perspective. Inflexibility to review rates – sides are always adopted; clients argue that some perceived high rates should be reduced but never suggest an increase to perceived low rates with contractors taking the juxtaposition;
2. Inappropriate indexation leads to 'one party' winning;
3. Too much work done in silos – 'us and them' – creates divides i.e. clients, contractors and supply chain all operate their individual processes with no one accountable for the end-to-end process which truly generates customer value. Lack of joined up end-to-end approach to asset management – fragmented accountability leads to inappropriate solutions and cost inefficiency;
4. Contractor inflates target cost to reduce risk of 'pain' leading to expensive service and lack of pressure on the contractor to be efficient. Insufficient understanding and control of actual cost on target cost reimbursable contracts;
5. Whole life cost of maintenance - success is measured based on cost of inputs (plant, labour, equipment) - £45 to repair a pothole without taking proper account of quality (durability of repair) and productivity leading to expensive service in the longer term;
6. KPIs - 100s of KPIs loses focus on the most important aspects of delivery. KPIs linked to contract extension become the only focus of the contractor resulting in some areas of the service struggling;

7. Client/supply chain communication - contractor does not open up channel of communication between client and supply chain resulting in limited client understanding of operations and prolongs the process of introducing innovations. Supply chain treated unfairly (not 'back to back') by contractor leading to lack of long term commitment from supply chain;
8. Issue resolution – although there are mechanisms in place in standard contracts for dealing with change (e.g. early warning and compensation event procedures), and also mechanisms exist for dealing with formal dispute (e.g. mediation, arbitration and litigation) there is little in the way of dealing with the resolution of issues where the parties cannot agree a way forward but do not wish to declare a formal dispute. The result can very often be unstructured and protracted deliberations significantly tying up senior management time that should be dedicated to managing the contract;
9. Measurement and Schedule of Rates items generally;
  - Aggregation of quantities
  - Minimum order value – grouping of work
  - Establishment items
  - Overheads
  - Site accommodation
  - Traffic management
  - Pothole, patches and reinstatements
  - Regulating and bond coats
  - Temporary works for structures
  - Adjustment items
  - Schedule of cost components
  - Disallowed cost
  - Direct fee
  - Sub-contracted fee
  - Risks
  - Inventory

The items listed in point 9 above are to be addressed by the HTMA Procurement Working Group (Obtaining Best Value from Constrained Budgets).



## Section 2 – Analysis of the issues

The issues identified in section 1 have been allocated into 3 categories;

- Procurement
- Operational
- Commercial

Each of the issues has been reviewed with both operational and commercial senior management from the organisations comprising the Steering Group. The analysis of the issues led to the compilation of a comprehensive list of topics that would benefit by improvement through the identification of alternative approaches.

The comprehensive list that will be taken forward to Phase 2 of this work is included as Appendix A covering;

- Cause
- Effect
- Potential outline solution (to form the basis of the Toolkit in phase 2 of this work)
- Linkage back to the key issue



### Section 3 – Structure and governance

Subject to further approvals from HMEP the proposed arrangements to develop the Toolkit are as follows;

1. Retain Steering Group as current structure to provide oversight and direction – includes both client and contractor perspectives.
2. Appoint lead author to;
  - Develop terms of reference for working groups including prescribed format for outputs etc.
  - Provide project management function including arrangement of Steering Group activity and progress reports
  - Ensure integration with other HMEP Toolkits and Products including avoidance of duplication of effort
  - Continue consultation with the industry
  - Create the Toolkit
3. Establish 3 working groups (Procurement, Operational, Commercial) comprising a cross section of client and contractor representatives. Work within the groups to be prioritised depending on their significance.

