

## Appendix 6 – Contractual Arrangements

### 1. Form of Contracts.

**Recommendation. It is recommended that the latest suite of NEC documents (NEC 4) be used for the future highway services contracts with amendments and additional clauses restricted to ensuring compliance with the Buckinghamshire Council constitution, governance and other corporate requirements.**

The New Engineering Contract (NEC) is a suite of standard contracts published by the Institution of Civil Engineers that is suitable for construction and maintenance works. The NEC suite includes versions that are suitable for a TMC, frameworks and professional services. These contracts all use a common structure and procedures are built upon the underlying principles of sound project management and proactive risk management. This enables common management systems and joint working to be implemented.

Some research on what other local authorities currently use and also those potentially going to market in the near future has been carried out. The results show that all but 1 highway authority currently use NEC 3, with a considerable number already using NEC 4 for some or all elements of work and the vast majority of others considering/proposing to move to NEC 4 when they re-tender.

The NEC suite enables contracts to be tailored to suit the needs of the Client and achieve appropriate risk allocation for the project/services by selecting a number of standard optional clauses e.g. the type of payment mechanism. Additional clauses can also be added to include for Client-specific requirements e.g. Local Government requirements. The NEC suite has become the default contract for infrastructure management and is endorsed by Government including the DfT and is widely accepted in the market. As well as being used by most local government bodies, the NEC is used by infrastructure operators including:

- Highways England
- Network Rail
- British Airport Authority
- Water Companies and other utility providers.

By using the NEC suite of documents will provide a good structure for management of the contracts, ensure compliance with Government direction and minimise the need for bespoke contract drafting. It will be market-acceptable and help reduce unnecessary risk pricing by the bidders.

### 2. Numbers of Supplier(s) per Framework.

**Recommendation.** It is recommended that

- **At least 2 suppliers be appointed for each lot within framework 1**
- **At least 2 suppliers be appointed for framework 2**

The Authority can determine the number of suppliers on any given framework if this is explicitly detailed in the tender documentation.

For Conventional Surfacing, Surface Treatments including footway surfacing and Plane and Patch, it is possible to specify the treatment types that will be required during the course of the framework and for the market to tender accurate prices for the specified treatment types. The work is essentially a commodity, with the specific programmes of work required during the framework being priced using the initial tendered prices. The Project Team did consider that there may be advantages in having a single supplier for these areas, but on balance, propose that there be at least 2 suppliers selected for

- Conventional Surfacing and reconstruction.
- Surface Treatments, surface dressing, micro asphalt and other specialist treatments.
- Machine lay plane and patch, footway reconstruction and drainage schemes under £500k.

While there is no direct need for a framework for construction and projects over £500k for the Highways service specifically, other service areas within the council have identified a requirement for such a framework. As such, it is also recommended that a framework for minor improvements and larger works in excess of £500k be procured and taken forward in conjunction with this project. It is also proposed that at least 2 suppliers be selected for

- Minor Improvement works and larger projects over £500k

The advantages and disadvantages of single provider and multiple provider options are set out below.

Single source v multiple supplier

Utilising the option to have a single source of supply is a powerful approach in a stable environment but can increase exposure to risk in the event of supplier default. Multiple sourcing, however, whilst decreasing the risk to the Council, can result in higher management costs due to the management of more than one supplier and the dilution of partnership working arrangements.

Advantages

<b>Single Source</b>	<b>Multiple Supplier</b>
Partnership between Authority and supplier allows co-operation, shared benefits and long-term relationship.	Alternative sources of supply in case of delivery failure or poor performance of single supplier
One set price	Increased probability of innovation within several suppliers
Potentially more competitive pricing initially, due to better knowledge of scope of work and economies of scale	Increased competition among suppliers lead to better potential quality, price, delivery and innovation.

Planning and scheduling - with only one supplier can better plan schedule of works	More flexibility to react to Authority requirements
Less admin and reduced resource on contract management	

Disadvantages

<b>Single Source</b>	<b>Multiple Supplier</b>
Greater dependency between Authority and Supplier	Reduced efforts by supplier to meet Authority requirements
Increased vulnerability of supply	Higher admin costs/contract management for the Authority
Increased risk of supply failure/disruption including access to capacity	More difficult to build relationships with multiple suppliers
Lack of opportunity for competition through mini competition	Potentially more difficult to plan ahead – decision making process on which supplier carries out what work.

The choice about the number of suppliers can be a very important strategic decision in procurement risk management. In the event of supplier disruption how would the Authority fair – if multiple suppliers, the Council would switch supplier, in the event of a single supplier the position would be to halt supply of the services. This risk may be mitigated through allowing the Council to reserve the right to purchase off the framework should the supplier be unable to meet our requirements. This would, however, likely erode the trust and relationship between the supplier and the Authority. The leverage of the supplier over the Authority is reduced by splitting our overall requirements among suppliers. The risks and costs associated to supply disruption may decrease accordingly. A multiple supplier allows various sources of supply to offset supply risks.

The other option to potentially mitigate this risk, is that the authority could revert to their term maintenance contractor to deliver elements of this work, but this would need to be built into the original contract to facilitate this, and this is an option that we are considering notwithstanding.

### **3. Contract Duration**

#### **Recommendation.**

- **For both Frameworks it is recommended that they be for the maximum period of 4 years, subject to no changes in legislation.**
- **For the Term Maintenance Contract and the Term Consultancy Contract it is recommended that the contract duration be for 8 years, with the option of 2 number 2 year extensions dependant on criteria (to be determined) being achieved/met and ultimately approved through a laid down process e.g. Cabinet/Cabinet member.**

There are a number of factors to be considered when deciding the duration of any contract.

If the contract is too short:

- It may be unattractive to the market thereby reducing competition or number of tenderers.
- The costs and level of resources required to carry out a re-procurement exercise, especially for a contract the size of the Term Maintenance Contract is considerable, both to the Council and the market.
- New contracts can take 12-18 months to “bed in” thereby reducing the time for optimal performance
- There is a shorter period for the bidders to recover sunk costs such as bidding and mobilisation and less time to amortize investments in fleet, equipment and ICT. This is likely to result in overall higher prices.

If the contract is too long:

- There is a risk of the provider becoming complacent
- There is a risk that innovation or new ideas may not be adopted
- There is a greater interval between testing the market.

For Frameworks, Public Contracts Regulations 2015, limit the duration to a maximum of 4 years, and it is believed that we should adopt this timescale.

Other factors which have to be considered are as follows:

- Market engagement has identified that 7 – 8 years is the minimum duration that the market would consider to be attractive
- this provides a window of 5 – 6 years of optimal performance following mobilisation and prior to contract end
- It is the economic lifespan of much of the equipment and other investments made by the contractor and the usual write-down period for contractors thereby enabling

an efficient commercial model. A shorter period will simply result in any costs being spread over a shorter period and subsequently increase costs.

- 2 number 2-year extensions give incentive for the provider to both perform well and improve performance. In addition, it also gives the opportunity for the council to continue with a good performing provider.
- The potential extension also gives flexibility to the council to extend if additional time is required to re-procure at the end of the contract period, due to unforeseen circumstances.

The risks of a longer duration can be addressed by including mechanisms in the contract such as:

- a. A robust Performance Management Framework which motivates high performance and penalises poor performance
- b. Regular (e.g. 3 yearly) contract refreshes to ensure that innovation and prices are in line with market thinking.

#### **4. Payment Mechanisms**

**Recommendation. It is recommended that the**

- **Term Maintenance Contract adopt a schedule of rates approach**
- **Term Consultancy Contract similarly adopt a schedule of rate approach based on hourly contractual rates**
- **The Frameworks/Lots be also on a schedule of rates and with option for Target Cost approach for small and larger projects.**

The main payment mechanisms that are applicable for highway term maintenance and construction works are:

1. Lump Sum
2. Schedule of Rates
3. Target Cost
4. Cost Reimbursable

**Lump Sum**

In this model, the contractor is paid a fixed amount (the lump sum) for delivering a defined piece of work or for meeting a defined output or outcome.

The Contractor therefore takes the commercial risk for completing the work within the lump sum. If the Contractor's costs for completing the work are greater than the lump sum, the Contractor loses money. If the Contractor's costs for completing the work are less than the lump sum, the Contractor makes a profit.

Lump sums are most suitable where the quantity of work and the associated risks can be accurately quantified (and priced) and the work is not subject to significant change.

Advantages	Disadvantages
<ul style="list-style-type: none"> <li>• The commercial risk sits with the contractor.</li> <li>• Can generate effective competition between bidders.</li> <li>• The Council has greater outturn cost certainty.</li> <li>• Relatively easy to administer the contract and to value the work.</li> </ul>	<ul style="list-style-type: none"> <li>• Requires a good understanding of the work and the risks in order to obtain efficient but sustainable prices i.e. there is a risk of bidders under-pricing the work leading to poor service delivery / insolvency / dispute OR bidders over-pricing unknown risks leading to unnecessarily high prices.</li> <li>• Any costs savings resulting from efficiencies or changes in the market will benefit the contractor only – not shared with the Council.</li> <li>• Additional costs will be incurred if the quantity or specification of work changes during the contract period.</li> </ul>

**Schedule of Rates**

In this model, the contractor is paid an amount calculated by multiplying the quantity of work done by a unit rate for the work. The unit rates are submitted by the contractor at the tender stage and are fixed for the duration of the contract but are typically adjusted (up or down) for inflation. The contractor therefore takes the risk on the adequacy of its tendered unit rates and the Council takes the risk of the quantity of work that is required.

A Schedule of Rates is most suitable where the specification for the work can be accurately defined but the quantity of work required is not known in advance and/or is subject to change.

Advantages	Disadvantages
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<ul style="list-style-type: none"> <li>• Shared risk between the Council and the contractor.</li> <li>• Can generate effective competition between bidders.</li> <li>• The Council has flexibility on the quantities of work ordered to suit its budget availability.</li> <li>• Commonly used across the sector so possible to benchmark rates between different suppliers / authorities.</li> </ul>	<ul style="list-style-type: none"> <li>• Any cost savings resulting from efficiencies or changes in the market will benefit the contractor only – not shared with Council.</li> <li>• Relatively high levels of administration required to order and value the work.</li> <li>• Need to check tendered unit rates are accurately priced and sustainable to avoid the contractor trying to “cherry pick” work with better rates during the contract and avoid doing work with loss-making rates.</li> </ul>
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**Target Cost**

In this model, the Council and the contractor agree a Target Cost for the work before the work is instructed. The Target Cost is an estimate of how much the work is predicted to cost and is typically built up using tendered pricing information. During the course of the work, the contractor is paid its actual costs for delivering the work (plant, labour, materials plus overhead and profit). At the end of the work, the actual costs paid to the contractor are compared to the Target Cost. If the actual costs are higher than the Target Cost, the Council and the Contractor share the overspend or “the pain” (usually) in equal proportions. If the actual costs are lower than the Target Cost, the Council and the Contractor share the underspend or “the gain” (usually) in equal proportions.

In our current contract we apply the pain/gain share on a sliding scale based around the total annual value of target costs and has been typically a 75/25 split in favour of the council, the last one carried out was in fact 82/18 split in favour of the council. The element assigned to the Council is re-invested back into the service.

Target Costs are typically used where the work (and risks) can be reasonably well defined but not fully defined at the outset and where a risk shared between client and contractor is appropriate.

<b>Advantages</b>	<b>Disadvantages</b>
<ul style="list-style-type: none"> <li>• Shared risk allocation between the Council and the contractor</li> <li>• Can motivate both parties to seek efficiencies and share in “the gain” resulting in less overall cost to the Council.</li> <li>• Reduces the need for contractor to include unnecessary risk in pricing.</li> <li>• Transparency of costs enabling</li> </ul>	<ul style="list-style-type: none"> <li>• Risk that the contractor artificially inflates the Target Cost at the outset in order to increase the “gain” element, although this should be mitigated via check and challenge.</li> <li>• Potential lengthy negotiations to agree a Target cost</li> <li>• Can be high levels of administration</li> </ul>

<p>inefficiencies / risks and therefore potential savings to be identified in future.</p> <ul style="list-style-type: none"> <li>Typically, the amount of actual costs that the contractor is paid is capped thereby limiting the maximum exposure of the Council</li> </ul>	<p>to record and audit actual costs and calculate the pain or gain shares.</p> <ul style="list-style-type: none"> <li>Can be less easy to benchmark costs against other providers / authorities.</li> </ul>
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<p><b>Cost Reimbursable</b></p> <p>In this model, the contractor is paid its actual costs for delivering the work (plant, labour, materials plus overhead and profit). There is no cap on the financial exposure of the Council.</p> <p>Typically used where the work (or risks) is unknown and cannot be defined at the outset.</p>	
<p><b>Advantages</b></p>	<p><b>Disadvantages</b></p>
<ul style="list-style-type: none"> <li>Flexible and enables responsive service.</li> <li>Reduces the need for contractor to include risk pricing.</li> <li>Transparency of costs enabling inefficiencies / risks and therefore potential savings to be identified in future.</li> </ul>	<ul style="list-style-type: none"> <li>All commercial risk sits with the Council.</li> <li>No incentive on the contractor to deliver efficiencies.</li> <li>High levels of administration to record and audit actual costs</li> <li>Not able to benchmark costs</li> </ul>

As identified, each of the payment mechanisms has its advantages / disadvantages and suitable applications. A Schedule of Rates arrangement does provide a payment mechanism that is well-understood by the market and is likely to be acceptable, if not the preferred model. The Schedule of Rates can be used to drive competition at tender stage (although the risk of unsustainable pricing must be managed) and it provides a relatively straightforward of benchmarking against other providers and authorities.