

Public Procurement Whitepaper June 2019

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Contractor financial distress – warning signs and options



DISTRESSED CONTRACTORS

- What are the warning signs of a contractor in financial distress?
- What can you actively do to ensure that your service is continued and delivered within the rules?



Content of this talk

Part One: Guidance

- Outsourcing Playbook - aimed at ensuring sustainable, safe delivery of outsourced contracts

Part Two: Warning Signs

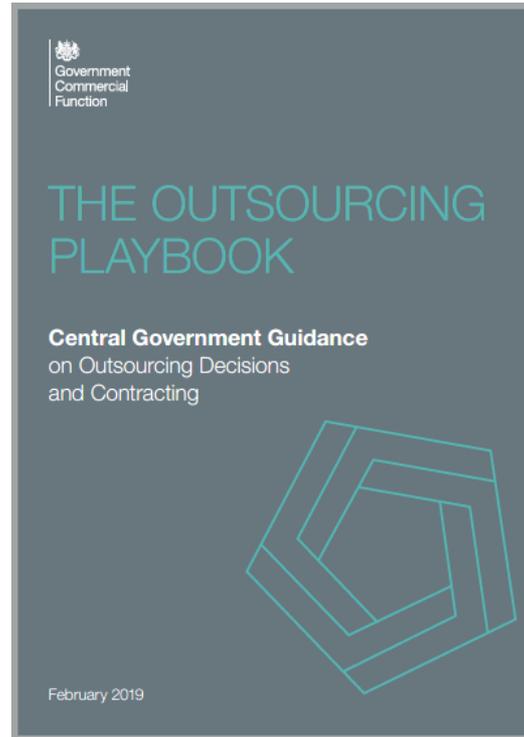
- Monitoring Economic and Financial Standing
- Corporate Financial Distress

Part Three: What can you do to ensure continued lawful delivery?

- New contractor/re-negotiation under Regulation 72
- Use of Regulation 32
- Alternatives



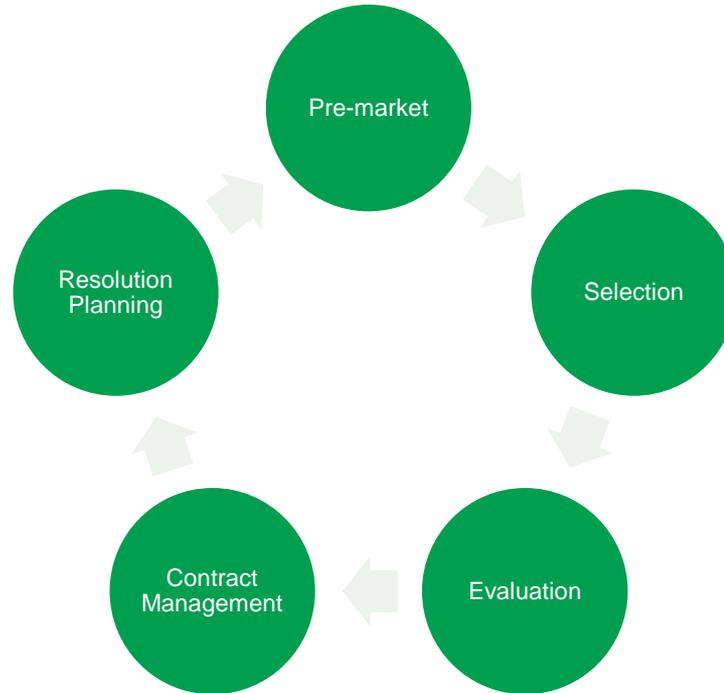
1.1 Outsourcing Playbook



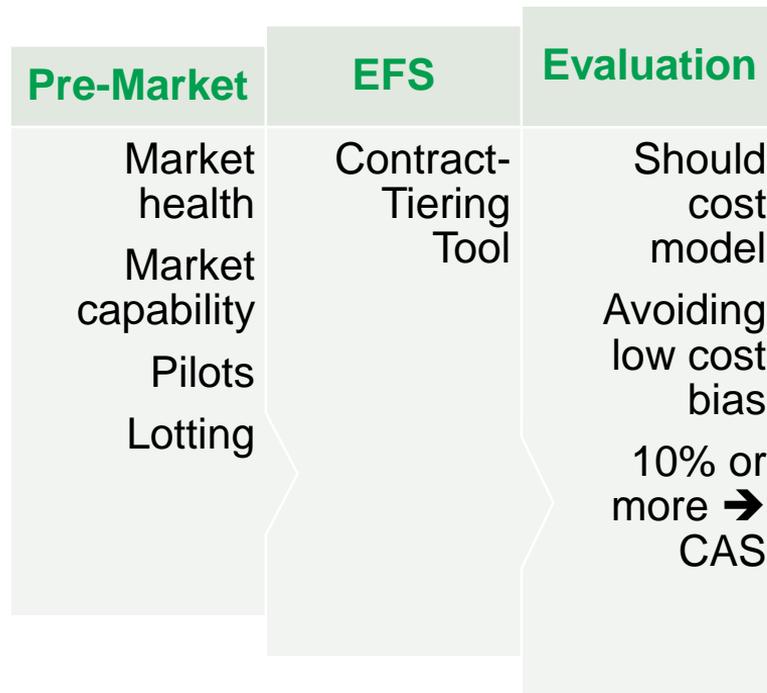
<https://www.gov.uk/government/publications/the-outsourcing-playbook>



1.2 – Important at each stage of the cycle



1.3 - 3 examples of the policies



1.4 Outsourcing Guidance Notes

- Market management
- Approvals process
- Make or buy
- Benefits measurement
- Risk allocation
- Payment mechanisms
- Payment mechanisms and risk allocation
- Dialogue and negotiation
- Data Quality and transparency
- **Assessing and monitoring the economic and financial standing of suppliers**
- Evaluating bids
- Resolution Planning



<https://www.gov.uk/government/publications/the-outsourcing-playbook>



Part Two – Warning Signs



ASSESSING AND MONITORING THE ECONOMIC AND FINANCIAL STANDING OF SUPPLIERS

Guidance Note

February 2019

- Principles & Contract tiering
- Mitigating financial risk
- **Monitoring EFS after contract award**

Appendices

- I: Standard Financial Ratios
- II: Interpreting standard financial metrics
- III: Financial assessment flowcharts
- IV: Comparison of credit ratings
- **V: Potential indicators of future financial distress**
- VI: Tools and information sources



2.2 The Warning Signs

	Financial	Non-financial
Business performance	<ul style="list-style-type: none"> Declining revenues, margins, return on capital, cash conversion. Profit warnings Increase in creditor days Delayed supplier payment Decrease in debtor days Declining stock turnover 	<ul style="list-style-type: none"> Resignation of key staff Late filing Gossip/intelligence Regulatory action Declining share price/shorting Major adverse announcements
Liquidity/ Solvency	<ul style="list-style-type: none"> High debt to equity ratio, rising gearing Declining interest cover Deteriorating liquidity, reliance on debt Covenant breaches Account qualifications, reduced dividends Requests for payments in advance Factoring Rising pension deficits and contingent liabilities 	<ul style="list-style-type: none"> Deteriorating relationship with lenders Credit insurance withdrawn Reduction of credit rating Company Watch H score below 25/D&B below 10



2.3 The warning signs continued

- Put EFS as a regular standing item at supplier/contract review meetings.
- Consider whether usual contract management team will lean towards “optimism bias”, requiring impartial scrutiny from time to time
- Contractor personnel disengaging from contract management is a red flag
- One of the most critical, and easiest, methods of monitoring is payment of the supply chain

2.4 Supply Chain - prompt payment

Regulation 113 – Payment of undisputed invoices within 30 days by contracting authorities, contractors and sub-contractors.

PPN 04/18

- 04/18: Taking account of a supplier's approach to payment in the procurement of major contracts

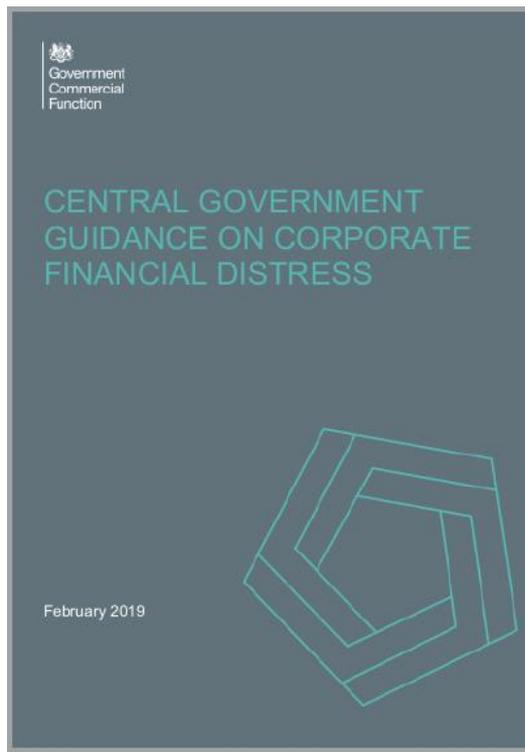
<https://www.bevanbrittan.com/insights/articles/2018/procurement-ppn-0418-taking-account-of-a-supplier-s-approach-to-payment-in-the-procurement-of-major-contracts/>

The Reporting on Payment Practices and Performance Regulations 2017

<https://www.bevanbrittan.com/insights/articles/2018/procurement-byte-on-supply-chain-3-of-3-the-reporting-on-payment-practices-and-performance-regulations-2017/>



2.5 Corporate Financial Distress



<https://www.gov.uk/government/publications/corporate-financial-distress>



2.6 Corporate Financial Distress

- Options for an organisation in financial distress
 - Solvent restructuring options:
 - Turnaround plan
 - Amend and extend
 - New money
 - Debt for equity swap
 - Asset sale
 - Insolvent options
 - Administration
 - Company Voluntary Arrangement
 - Liquidation



Part 3 – What can you do to ensure continued delivery of your service?



3.1 Options for continuing delivery of the service

Two broad options to consider in tandem:

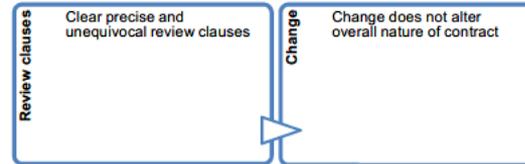
- (1) Continue with the output from the existing procurement
 - New contractor?
 - Re-scope/re-negotiate?
 - Step-in?
- (2) Consider alternative re-procurement options
 - Start again and run a new procedure?
 - FW/DPS?
 - Regulation 32?

Hand-out – Quick summary of permitted changes under Regulation 72

Quick summary of six “permitted changes” to concluded contracts – PCR 72

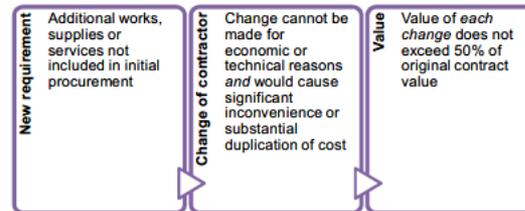
Change 1 Clauses in the contract CCS “Any change”

PCR 72(1)(a)



Change 2 New requirements, same contractor CCS “Major change”

PCR 72(1)(b)



3.2 New contractor?

Change of contractor permissible if falls within 72(1)(d)(i) or (ii)

72(1)(d)(i) - review clause. Must be clear, precise and unequivocal and must be provided for in the initial procurement documents.

An example would be step-in rights.

Awarding to second placed bidder in event of immediate failure?

72(1)(d)(ii) - Corporate restructuring. Various different forms seem permissible, whether intra-group transfer, share sale or even asset sale.

- Must fulfil qualitative selection criteria

3.3 New contractor continued

- Right to veto/object to new contractor should be limited to objective and non-discriminatory criteria
- Can other changes to the contract be made if change contractor?
 - Under 72(1)(d)(i) – yes, provided these are part of the clear, unequivocal review clauses, and clear how the changes will be made, and they do not alter the overall nature of the contract.
 - Under 72(1)(d)(ii) (corporate restructuring) – a change of contractor is only allowed provided it does not entail other substantial modifications to the contract, and is not aimed at circumventing the Regulations.
- Likely that *some* modifications need to be made if changing contractor?

3.4 Substantial modifications

Regulation 72(8): A modification is substantial where it:

- (a) renders contract materially different; or
- (b) Introduces conditions which, if part of the original procurement, would have attracted additional participants/allowed for admission/acceptance of other candidates/tenders; or
- (c) Changes the economic balance in favour of the contractor in a manner not provided for in the original contract; or
- (d) Extends the scope of the contract considerably; or
- (e) Replaces the contractor other than as in 72(1)(d).

3.5 Renegotiation/re-scoping

Request for improved payment terms – is this allowed?

- Regulation 72(1)(a) - clear precise review clauses, e.g. indexation
- Regulation 72(1)(c) – unforeseen circumstances – *some* causes of financial distress (e.g. force majeure?) may be unforeseeable but be cautious as financial distress not uncommon
- Regulation 72(1)(e) – where the modifications are not substantial – changing economic *balance* in favour of contractor is a substantial change (but if all contractors would have been in the same position, would this be permissible?)
- Regulation 72(5) – de minimis modifications in value – NB add up successive changes. Must not alter nature of the contract.

3.6 Re-scope to reduce services?

This may be possible, but not if it is a substantial modification

Reduction in scope and matching reduction in price could still be a problem:

- C-549/14 – Finn Frogne (27.11.14) (2004/18 Directive)
- Global communications procurement by Danish State for all supply and maintenance of all emergency response services. Contract awarded to Terma (value €70m). Dispute arose and settlement entailed reduction of the scope of contract to supply of a radio communications system for regional police forces (value €4.69m). This was a material change to the contract because the changed opportunity would have been of interest to a different group of operators.

3.7 VEAT notices and CANs

The first ground of ineffectiveness will not apply where the CA *considered* the award of the contract without prior publication of a notice to be permitted by the Regulations, publishes a valid VEAT and stands still for 10 days.

Publication of a valid VEAT notice - must contain a description of the justification of the decision of the CA not to advertise.

- *Fastweb* (C-19/13) – Must act diligently in reaching conclusions.
- *Faraday* [2018] EWCA Civ 2532 – The justification must be complete

CANs – must be filed if relying on “Additional Works” or “Unforeseen Circumstances” provisions in Regulation 72(1)(b) or (c)

3.8 Start again with a new procurement

- Take back in-house?
- Framework or Dynamic Purchasing System
- Open or restricted procedure?
- Regulation 32, e.g. competition is genuinely absent for technical reasons or extreme urgency, but NB – narrowly interpreted.

References

- *The Law of Public and Utilities Procurement* Vol 1 – Professor Arrowsmith, Third Edition, 6-293, page 596.
- *Transfer of contracts covered by the EU public procurement rules after insolvency* - Steen Treumer, PPLR 2014, 1, 21-31

Thank you

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