REPORT TO: FLOOD ALLEVIATION SUB-COMMITTEE ON 11 OCTOBER 2006

SUBJECT: MORAY FLOOD ALLEVIATION SCHEMES – CONTRACT STRATEGY AND TARGET SETTING PROCESS FOR CONSTRUCTION WORKS

BY: DIRECTOR OF ENVIRONMENTAL SERVICES

1. REASON FOR REPORT

1.1 To advise Members of the next steps in the process to derive a target cost for the Forres (Burn of Mosset) Scheme and ask members to note the advice of officers with regard to contracting services for this and future schemes

1.2 The report is submitted to the Committee in terms of Section D (23) of the Council’s Administrative Scheme relating to the functions of the Council under the Flood Prevention (Scotland) Act 1961 as amended by the Flood Prevention and Land Drainage (Scotland) Act 1997.

2. RECOMMENDATION

2.1 That Sub-Committee note that:

(i) Morrison Construction, subject to meeting contractual obligations including agreeing a target cost in accordance with the Contract terms and the Works Package Target Setting Methodology, will be awarded construction of the Forres (Burn of Mosset) Scheme;

(ii) subject to review of the Contract Strategy and compliance with cost and performance standards there will be continuing involvement of Morrison Construction in the remaining schemes;

(iii) the start date and target cost for the Forres (Burn of Mosset) Scheme will be reported to future Sub-Committee(s) once the position regarding the statutory processes becomes clearer.
3. BACKGROUND

3.1 Contract Strategy

Policy and Resources Committee of 31 October 2001 approved the procurement strategy for contracting services for Moray Flood Alleviation Schemes (para 14 (ii) of the Minute refers). The strategy adopted best practice guidance for construction procurement at that time. It proposed appointing one single contractor on a long-term contract to construct the Lhanbryde scheme and assist in the development of other schemes. For tender evaluation purposes, a quality:price ratio of 70:30 was agreed. Contract was to be the New Engineering Contract (NEC) Option C – Target Cost, which incentivises cost savings achieved during construction. Future works package target costs would be negotiated on the basis of tendered Lhanbryde activity schedules and their assumptions, programming and tendered pricing methodology to provide a transparent target cost. The aim was to arrive at a target cost on the same competitive basis as the tender. An outline of the proposed methodology for achieving this is described later in this report.

3.2 European Union Procurement Procedures

Concerns have been raised that original estimated value of the contract in the European Journal advert is far below the anticipated final construction costs. There is a risk that the Council could be challenged under European tendering legislation by a contractor who was excluded from the tender or who did not tender for these works because the value was too small. It is considered however that any such challenge could be rebutted on the following grounds:

- The Council acted with the best knowledge available at the time of tendering.
- More realistic estimates of the tender amounts were issued to Contractors who were actually shortlisted to tender.
- Contractors would have to make a claim within a reasonable time period after the competition process. They may now be time barred.

Any risk of challenge is very remote. To review the tendering process could mean breaching our contract with Morrison Construction, which is likely to incur a risk of challenge by them. This risk is very real and, on balance, it is not considered worthwhile reviewing the European tendering legislation process.

3.3 The Selection Process

The three-stage selection process takes some time. Invitations to tender were issued to five short-listed contractors on 24 July 2003 and returned on 12 September 2003. The tender documents required contractors to submit a “Quality Bid” and prices for three components:
• A target cost for Lhanbryde (worth 25% of the total tender amount)
• A price for assisting in design development (worth 5% of the total tender amount)
• A price for other schemes based on the fee percentage applied to the Lhanbryde scheme, where actual cost of this work would be £30 million. (worth 70% of the total tender amount).

The Instructions for Tenderers and the Contract Documents stated “The estimated combined construction cost of the Moray Flood Alleviation Schemes is between £50 - £100m.” This wide range reflected the uncertainty regarding the scope of the schemes and knowledge gained since the strategy was approved that the costs would be considerably higher than envisaged in October 2001. The Contract, while indicating an intention to award future work to the successful tenderer, made no commitment and stated that any future award would be subject to conditions regarding performance and costs. The currently estimated construction cost is now in the order of £90 million, forming part of an overall cost of around £150 million.

Environmental Services Committee of 26 November 2003 (para 11 of the Minute refers) approved award of the Contract to AWG Construction Services Ltd (now Morrison Construction) who submitted the highest scoring quality bid and the lowest price.

3.4 Target Costs for Future works Packages

The Quality Bids from contractors required each to provide detailed methodologies on how costs were derived to demonstrate transparency and auditability. This was so that the Council could determine that the target cost of future work packages would represent value in accordance with the tendered methodology and fee percentages.

A comprehensive “Works Package Target Setting Methodology” (the Methodology) has been drawn up to underpin the contractor’s tender submission that expands upon it and links it to Council procedures. The key components of the process are: -

• Morrison Construction receive detailed works information including construction drawings, schedules, specifications and the like;
• Morrison Construction review the above and query areas of uncertainty;
• Royal Haskoning review works information and reissue;
• Morrison Construction apply Lhanbryde Scheme tendered methodology and percentages, etc, to derive a target cost;
• Royal Haskoning review target cost;
• Reviewed target cost is audited by a Council appointed independent cost consultant familiar with these contract types and the process;
• Report from independent cost consultant, in due course of negotiations, certifies to the Council that the target cost represents value in accordance with the Tender.
A recommendation is made to the appropriate Council Committee to award the works package to Morrison Construction in accordance with the Contract.

Mobilisation and construction start.

Award of further major works packages to Morrison Construction under this Contract is subject to satisfactory performance and formal Committee approval of an agreed price that meets the terms of the Contract, thereby ensuring value for money.

Environmental Services Committee of August 2006 was advised that the Contract provided a framework for developing a target construction cost for future work packages. The Committee agreed that cost/project management consultants be appointed to provide an independent assessment of Flood Alleviation Scheme construction costs and provide expertise to ensure that appropriate arrangements are in place to assess value for money of the contractor costs. The proposal was for separate appointments to:

- Appraise Morrison Construction’s performance to date; and
- Audit the target cost of the Forres (Burn of Mosset) Scheme.

These appointments are in progress. The first appointment is for a relatively small amount and should be concluded by 20 October 2006 and the second should be concluded by the end of November 2006. These time scales are critical to a start date for the Forres (Burn of Mosset) scheme that could start as early as spring 2007 if statutory processes can be concluded swiftly.

The Committee was advised that to consider how the process can address the Council’s obligations in terms of audit scrutiny and Best Value, a presentation on the proposed Methodology would be given by Barbara Hellett, Elgin Scheme Manager and Neil MacLeod, Director of Morrison Construction Limited to Senior Officers of the Council. This took place on 28 September 2006. In attendance were The Director, The Chief Financial Officer, The Chief Legal Officer, The Head of Direct Services and the author attended. The outcome is reflected in this report.

### 3.5 Considerations of Officers

While the Methodology has not been finalised, Officers are prepared to recommend, in principle, and subject to satisfactory performance, that Morrison Construction be invited to submit a target cost for the Forres (Burn of Mosset) Scheme, in accordance with the Contract. The key reasons are that at the conclusion of the process:

- Morrison Construction will have to have met their “satisfactory performance” criterion;
- The derived target cost would represent value for money;
- Planned time savings between ministerial confirmation of the scheme and works start will be achieved;
• Morrison Construction have participated in and are familiar with the Consultant’s design; and
• There are no EU procurement regulation impediments.

The Methodology is being finalised in consultation with the Chief Financial Officer. The process described in it takes 22 weeks to complete and it is therefore potentially critical to a works start date for the Forres (Burn of Mosset) Scheme.

Officers consider that a cost consultant (referred to above) will need to be appointed to confirm whether the process adopted will continue to demonstrate value for money.

Five years has elapsed since the Contract Strategy was approved and much more is known about the nature and extent of the schemes. Equally, public sector construction procurement guidance has developed in that period. Officers consider it prudent and good practice to review the Contract Strategy and report back to this Sub-Committee with regard to award of future schemes.

3.6 Scottish Executive Grants

Once the Methodology has been finalised and approved, a copy will be sent to the Scottish Executive for information and comment as appropriate. This is because the agreed target cost will form part of the application for grant funding in due course. The Scottish Executive will offer grant in relation to the costs of developing the scheme to date when Ministers confirm a scheme. However, the Scottish Executive will have to approve the cost of the scheme, including the target cost, before offering award of grant. This means that the Council cannot enter into a contractual arrangement with a contractor until the Executive has approved the costs and written to the Council confirming award of grant.

3.7 Forres (Burn of Mosset) Scheme Costs and Risks

This report relates only to the construction target cost. The scheme cost includes many other headings such as investigations, surveys, studies, design, land compensation, site supervision and the like. The contractor has provided advice and contributed to reducing construction risk. The Council will retain risks that cannot be managed effectively by the contractor and the approved cost of the construction works will include this provision, derived through an assessment of impacts and probabilities of unforeseen events. The approved budget would therefore be target cost + client risk allowance for monitoring and reporting. Indicatively the whole life cost of the scheme including preparation, construction, compensation, operational costs, risk and miscellaneous costs was expected to be in the order of £11 million, of which £8 million would be construction costs. However there will be increases to cover anticipated costs of compensation, the recent agreements to resolve objections and construction inflation. The Sub-Committee will be advised as these costs are refined.
4. **SUMMARY OF IMPLICATIONS**

(a) **Corporate Development Plan/Community Plan/Service Improvement Plan**

Delivering effective flood alleviation schemes is a priority in the Corporate Development Plan 2004 – 2007.

(b) **Policy and Legal**

The proposals form part of the Council’s statutory duty in regard to Best Value, value for money and probity.

(c) **Resources (Financial, Risks, Staffing and Property)**

The costs of this consultant will be included in the overall scheme cost. There are no staffing or property implications. The proposals are intended to reduce financial risk and will be reported as part of the cost monitoring arrangements to the Flood Alleviation Sub-Committee.

(d) **Consultations**

The Chief Financial Officer, Chief Legal Officer and Head of Direct Services have been consulted and their comments taken into account in the report.

5. **CONCLUSION**

5.1 This is the first time this Council has faced the challenge of implementing the contract strategy for a major works package. The Officers conclude that the measures described in this report will provide confidence that the process is sound in respect of value, probity and auditability. Review of the strategy is intended to ensure that schemes that follow the Forres (Burn of Mosset) Scheme meet with these criteria.

5.2 The cost of the Forres (Burn of Mosset) Scheme aggregated with the Lhanbryde Scheme will be less than the indicative amount in the original OJEU Contract Notice of April 2002. From this, together with, and subject to the measures set out in this report and to be contained in the finalised Methodology, it is concluded that it would be reasonable and value for money to proceed with award of the Forres (Burn of Mosset) Scheme to Morrison Construction in accordance with the Contract.

5.3 The Contract Strategy, being five years old, should be reviewed.

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Background Papers:

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