



Rachel Reeves MP
Chair, Business, Energy and Industrial Strategy Committee
House of Commons
London
SW1A 0AA

Rt Hon Frank Field MP
Chair, Work and Pensions Committee
House of Commons
London
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Tuesday 19th June

Dear Chairs,

Thank you for your letter of 29 May 2018, referring to the role of Crown Representatives and the circumstances leading up to the liquidation of Carillion. While I welcome many aspects of the report produced by the joint committees, I am disappointed that the committees came to the conclusion that the Crown Representative “served no noticeable purpose” in this situation.

I am confident that the Crown Representatives fulfil an important role in a wider system of assurance and supplier relationship management. The Crown Representatives are senior, board level executives who work for the Cabinet Office on a part-time basis. The Crown Representatives provide valuable insight from their personal experience and also act as a focus for Government’s relationships with the most senior executives in the suppliers.

While the Representatives are very senior, experienced people, they can only react to information given to them by the company. If the information that the managers and directors we interact with have been given is incorrect, or if those managers fail to pass that on to us correctly, then problems can of course arise. We should also recognise that the Representative’s role is one of a senior customer, they are not directors of the supplier companies and do not have the power of directors, or indeed of shareholders.

They are also **not** the only resources dedicated to this task. They are supported by a full time Markets and Suppliers team which comprises a number of relationship managers and business analysts, including, for some suppliers, a full-time partnering

manager, at SCS level, who in the case of Carillion had been in place since May 2017. The Markets and Suppliers team is based in the Cabinet Office and led by a Director who reports to the Government Chief Commercial Officer.

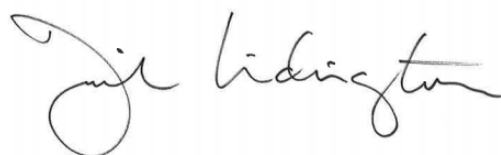
In the case of Carillion, after July 2017 the interaction with the company was sufficiently intense to involve both of these senior officials continuously. As the NAO has reported, there were 37 formal meetings or conference calls between the Cabinet Office and executives of Carillion after July 10 and numerous telephone calls and texts. The company was providing detailed financial information, including weekly cash flow forecasts, that went well beyond our normal interaction with Strategic Suppliers. This matter was therefore receiving the full attention of the most senior commercial staff in Government, with regular support from the Chief Executive of the Civil Service.

Regarding your other questions, you will be aware that both the Public Accounts Committee and the Public Administration and Constitutional Affairs Committee have active inquiries into the Carillion liquidation and are following very similar lines of questioning. I have appended some answers to these questions in an annex to this letter and hope that you find them helpful.

I hope this letter will alleviate your concerns that there is “an urgent need to review the role of the Crown Representatives to ensure that issues with other strategic suppliers can be spotted and dealt with at an earlier stage”. Government will draw important lessons from events leading up to and following the liquidation of Carillion, but my initial view is that the role of Crown Representative is highly valuable and that the temporary vacancy that occurred during three months in 2017 did not compromise our ability to recognise Carillion’s problems and construct an appropriate response.

Indeed, I feel we could improve our supplier management by increasing the number of Crown Representatives and Strategic Partnering Managers we have; at the time of Carillion’s July profit warning we had 14 Crown Representatives and 10 partnering managers covering 30 Strategic Suppliers. Increasing the number of these resources would allow us not only to cover more suppliers, and hence more of our spend, but would also mean that we have fewer temporary gaps in cover.

I would like to thank the Committees for their continuing interest in this important topic.

A handwritten signature in black ink, appearing to read 'David Lidington', with a large, stylized initial 'D'.

RT HON DAVID LIDINGTON CBE MP

Annex - Answers to questions posed by WP/BEIS Select Committees

1. What consideration has been given to widening the scope of risk assessments to include contracts with third parties?

Risk assessments already include consideration of contracts with third parties, as they look at the total financial health of a supplier and not just the health of that supplier's portfolio of contracts with Central Government. For contracts that the suppliers hold with private companies we have to rely on publicly available information, as under normal circumstances we have no status that would allow us to access confidential corporate information. We can and do talk to customers elsewhere in the public sector, and these insights prove valuable in understanding the performance of suppliers and in addressing issues that may arise.

2. Why are contracts not held directly by Government factored into risk assessments?

Risk assessments do include consideration of major contracts where the Strategic Supplier is a subcontractor to another supplier; as an example, until 2017 much of HMRC's IT was contracted with Capgemini, but included major subcontracts with Fujitsu and Accenture. Performance on these subcontracts were regularly considered in their risk assessments. As the Risk management policy makes clear, the scope of the policy is restricted to bodies classified as part of 'Central Government' by the Office of National Statistics. It is the direct responsibility of the Cabinet Office team to monitor the performance of suppliers on contracts held by these bodies, although as mentioned above we maintain a close interest in contracts held by other public bodies such as NHS entities.

The contract mentioned in your letter, to build the Royal Liverpool Universities Hospital, was one such contract. As you point out it is held by a Project Company, a private sector entity as part of PFI arrangements. The NHS Trust that is the ultimate customer was engaged with the Cabinet Office as part of contingency planning against the possible failure of Carillion as was the project company. There have been regular communications with these bodies and other interested parties; the Department of Health and Social Care, NHS Improvement and HM Treasury; coordinated by the Infrastructure and Projects Authority, which is the body within the Cabinet Office with stewardship responsibilities for PFI contracts. These discussions continue as we seek to complete the hospital as quickly as possible.

3. Are all risk assessments based on out of date financial data?

You point out that the September 2016 report used an old figure for turnover (2014 rather than 2015). Your researchers will probably also be aware that this was corrected in the November 2016 report. While turnover is not an indicator of risk, I

can assure the Committees that all risk assessments conducted today use the latest available financial information.

4. What was the rationale for Carillion's risk rating?

The rationale for recommending a provisional designation of Carillion as 'high risk' is contained in the annex to the agenda item of 28 November 2018 published by the Public Accounts Committee; that the triggers for Financial Distress as set down in the Strategic Supplier Risk Management Policy had been met. The letter also makes it clear that the supplier would be invited to make representations. The risk assessment for January 2018 states that the Commercial Relationships Board decided not to confirm the high risk rating "as this would not be beneficial to HMG at this time".

To expand on this: the purpose of the risk assessments rating is to alert colleagues to the status of suppliers and, in the case of financial distress, to enable us to gain information from that supplier to help us manage the situation and ensure continued delivery of public services. It is necessarily a confidential process as the information exchanged is sensitive, and in Carillion's case, covered by insider trading laws.

By December 2017 our first purpose had been fulfilled as demonstrated by the considerable work done on contingency planning across the public sector, and we were already receiving information from the company, such as weekly cash flow projections, well in excess of that stipulated under even the 'high risk' rating.

We were prompted to consider moving the rating to 'high risk' by the company's announcement that it might breach its year end lending covenants. The company's CEO wrote to us, in a letter that we have shared with the NAO, flagging his concerns that lenders and employees would react negatively to this news should it become public, at a time when the company was still in 'constructive discussions with their lenders' over new financing. Indeed on 22 December 2017 Carillion agreed with lenders to move the date at which covenant tests would be performed from January 2018 to April 2018.

Given that we were already getting the information we required, there was no gain for the taxpayer, and some meaningful risk, in moving the rating to Black or 'high risk'. We therefore kept the rating at Red, but under the proviso that we would look at it again at any point if the company failed to continue to give us the financial information we were requesting. We are confident that in light of the outcomes that the right choice was made.

Bear in mind that one of the leading outside debt rating agencies had maintained their 'delivery risk indicator' score for Carillion at 'minimum risk' from January 2017

through to 21 November when they moved it to 'above average', only moving to 'high risk' on 9 January.

The overall effect of the Cabinet Office risk process is that we reacted swiftly to put in place plans that when executed ensured continued service provision, despite the highly regrettable collapse of a large supplier.