Dear Chairs,

As you are aware, Crown Representatives are one of the principal means by which government manages its relationship with strategic suppliers. They are senior, board-level executives who work across departments to ensure that a single and strategic view of the government’s needs is communicated to the market, to identify areas for cost savings, and to act as a point of focus for supplier-related issues.

But they are part of a broader supplier management system, led by the Markets and Suppliers team in the Government Commercial Function. Crown Representatives are supplemented by Strategic Partnering Managers (SPMs), who work to deliver better value from outsourced contracts by aligning government’s commercial strategy with supplier and market capability. The work which Crown Representatives and SPMs do is informed, as well as by regular meetings with suppliers, by the Annual Review Process. Annual Reviews offer an opportunity to scrutinise suppliers’ corporate governance strategy, social responsibility policies, commercial strategies, financial position, market performance and capitalisation, supply chain payment practices, and employment strategy, building on the latest (published) audited reports.

Due to the success of the Crown Representative Programme we have increased the number of Crown Representatives from 17 in 2015 to 21 in 2018. Supplementing the expansion of the Crown Representative Programme we have increased the number of SPMs from one in 2015 to 14 in 2018. These programmes oversee around £17 billion of the total £49 billion of spend on central government contracts. The Ministry of Defence is now ramping up its own supplier management programme, which mirrors the Crown Representative and Strategic Partnering Programmes.

In addition, we are training departments in strategic supplier relationship management to drive consistency of approach across government. Covering 10 departments, the first wave is due for completion this year, with the second wave concluding next year.
Your letter indicates a misunderstanding of the role of Crown Representatives. While they are senior executives with many years experience, their main focus is dealing with the business as usual relationships with suppliers. If more significant problems arise they are escalated to the full-time resource in place to manage them, in particular to the Director of the Markets and Suppliers team and the Government Chief Commercial Officer.

**Carillion's Crown Representative & engagement**

We have conceded that it would have been better to have had a Crown Representative in place for Carillion for the whole of 2017. The absence of a Crown Representative for a short period was not, however, an impediment to Cabinet Office's ability to manage our relationship with Carillion, because the Director of Markets and Suppliers stepped in with her wider team and led engagement with the company. In the run up to its demise Carillion was only paid for work and services that it had actually delivered, and the Annual Review work that the outgoing Crown Representative had done in March 2017 provided much of the information which later ensured the continuation of public services and the re-employment of circa 85% of Carillion's UK workforce. In short, the system worked as planned to protect the public interest even in the face of such a significant corporate failure.

I remain clear that government, as a customer of Carillion, could not have anticipated the scale of the July profit warning. As the National Audit Office report on the Carillion insolvency confirmed, we were not surprised by the profit warning per se but by the scale of it, as was the market, evidenced by the 70% share price adjustment. As the NAO also noted, and contrary to the assertion in your letter, when Carillion's financial difficulties began to emerge government significantly intensified engagement with the company through the processes described above. In the seven months before Carillion’s profit warning in July 2017, government officials formally met or called senior company representatives 11 times. After the July profit warning Cabinet Office formally met or called Carillion 50 times, which included nine meetings in January in the run up to the insolvency announcement.

**Risk management**

As regards Cabinet Office’s risk rating system, as the NAO report shows, we moved Carillion to red immediately following the profit warning. The fact that the Carillion board released such serious price sensitive news about multiple contracts simultaneously indicates that up until then, (when they concluded their internal review) they also were unaware of the scale of their problems. We are senior customers, not shareholders or directors, and we do need to rely to an extent on data that its directors give us. That said, at that time Carillion, and the wider market, were expecting a financing solution to be put in place. When it became apparent that the company would in fact breach its year-end covenants Cabinet Office considered moving its rating to black, but by that time the intensity of engagement with the Crown Representative and the rest of the Markets and Suppliers team was such that we already had a greater level of information than even a black rating would have provided. The decision to keep Carillion’s rating at red was made because the objective of the risk rating system is to flag potential issues without making them worse. As the company was concerned that a potential disclosure of the rating would put them at risk, prejudicing public service delivery and thus precipitating the very thing that the risk rating is designed to prevent, Cabinet Office decided to leave the rating at red and review it again in the
New Year. It is important to note that, in comparison with our actions, one leading debt rating agencies maintained their ‘delivery risk indicator’ score for Carillion at ‘minimum risk’ between January and 21 November 2017, at which time they moved it to ‘above average’, and then only to ‘high risk’ on 9 January 2018.

While I am confident that the right actions were taken by Cabinet Office to handle Carillion, my officials are nonetheless reviewing the risk management policy to address any potential improvements that could be made to the system for the future. This will include looking at the role of Crown Representatives in supplier management. A new risk management policy will be in place by early 2019.

“Insiders”

As your letter acknowledges, part of the intensification of engagement involved asking the company to agree to a small number of government officials, from the Commercial Function and UK Government Investments, to become ‘insiders’. In September 2017, therefore, this group of officials began under controlled circumstances to receive information from Carillion relating to engagement with creditors and the company’s financial status, information which allowed Cabinet Office to make independent judgements about the state of the company, rather than relying on company-provided updates. This information enabled Cabinet Office to adjust our contingency planning in a way that would not have been possible without it.

You are right that in managing suppliers we can only deal with publicly available information, and I agree that it is important for government to look again at the audit reports which companies receive. One of the key changes which Cabinet Office has suggested, therefore, is asking companies to publish their total internal and external audit fees in relation to revenue, profit, net assets and number of legal entities, as measures of corporate complexity (Carillion’s were remarkably low for a company of that size and complexity). In doing so, shareholders and other interested parties would be able to see how seriously companies are taking their internal management controls, something which your excellent report highlighted may have been circumvented in Carillion’s case.

Improving outsourcing

It is also not accurate to say that government is not taking action to improve its ability to outsource successfully. Cabinet Office and Treasury are conducting a major programme of work, which will develop a number of actions that government and suppliers can take jointly to improve public outsourcing and to make government more resilient should situations as regrettable as the Carillion insolvency occur again. While we will continue to look at resources, this Cabinet Office and Treasury programme is seeking to enable government to, for instance, deepen its insights into the market, to better manage its relationships with suppliers, to more successfully establish its requirements before taking them to market, and to more effectively manage contracts once in place.

Finally, it is important to recognise that the case of Carillion was neither a failure of the Crown Representative programme, nor the result of a systemic weakness in government. In fact, the work undertaken by the Government Commercial Function over the last 18 months to build
resilient systems of supplier management and improve commercial capability was one of the main reasons why the effects of the insolvency were not far wider-reaching. As I think your inquiry into the Carillion insolvency demonstrated, the underlying issue was that this was a poorly-run construction company which, through a series of bad decisions, ran out of cash.

I hope this letter provides the extra information which you required and addresses some of your concerns about the Crown Representative programme. I remain grateful for your committee’s continuing interest in public outsourcing, and its contribution to getting the provision of public services right.

Rt Hon David Lidington CBE MP