



Briefing 10/52 September 2010

Connaught PLC into administration – impacts for councils

To: All housing and building maintenance contacts

To: All contacts in England, Scotland, Wales and Northern Ireland

Key issues:

Connaught caught by council deferred decisions to upgrade stock ahead of spending cuts

Impacts for councils, sub contractors, suppliers and staff

Stock market value of £626m wiped out in under 4 months

1. Introduction

Connaught PLC was placed in the hands of administrators KPMG on Tuesday 7th September along with its main division, Connaught Partnerships Ltd, after failing to secure further funding from its banks. The social housing maintenance group has been hit as councils deferred projects to upgrade their stock of social housing ahead of government spending cuts. After a shock profit warning in June, its cash flow problems were exacerbated by nervous suppliers and by subcontractors demanding upfront payment.

Connaught Compliance Ltd, National Britannia Holdings, Fountains Limited & Connaught Environmental Ltd other branches of the organisation, are not in administration

Connaught has been accused of 'capitalising' bid costs – treating them as an asset rather than as an expense - and that this approach has flattered its profits. It is an approach which allows costs to be converted to an asset (via the Profit and Loss Account) if the investment is expected to lead to future profits. This way costs incurred are seen as an investment in the business. Some contracts had been won on extremely thin margins whilst invoices had been sent out late and cash levels were being massaged by extending payment terms to suppliers at critical periods. Clients will be aware that Connaught had been having problems since a profit warning in June.

2. What can councils do?

Councils should be aware of factors relating to existing contracts with Connaught, including those listed below:

- Some contracts will have a clause stating that they can be ended automatically if an administrator is appointed whilst others will end only if the client serves a notice to determine.
- In a reactive repairs contract there is a requirement to continue providing the service.
- Planned works contracts may differ because it is harder to justify a re-procurement without going through OJEU.
- Regulations allow for the appointment of a contractor in an emergency without going through OJEU.
- Re-appointments should last a limited time as full re procurement takes place.

- An alternative is to see whether the administrators agree to a new contract on the terms of the old one.
- There is a chance that landlords may have to pay Connaught as well if they pay new contractors for any past valuation – so they should avoid doing so.

3. Existing contracts

Morgan Sindall has bought up £28m worth of Connaught contracts expecting to save 2,500 jobs. They will move to Lovell the affordable housing operation of Morgan Sindall. However if those contracts are ended by the client Morgan Sindall have effectively bought nothing and the contract will be managed with whoever the client agrees.

The same is true of Mears, the social housing maintenance group, who have agreed a deal to acquire eight contracts, potentially saving a further 1,000 jobs.

Outstanding Connaught contracts which KPMG have been unable to sell are at Norwich City Council, Arun District Council, the Raglan Housing Association, Southern Housing and Town & Country Housing.

A number of councils and housing associations have, or are seeking to, end contracts with Connaught with some landlords drafting in temporary workers, appointing short term contractors or taking services in house as emergency measures to ensure service provision.

Councils with framework agreements in place have been able to re-allocate work to those on the framework without have to go through another procurement process.

4. APSE comments

APSE sees the collapse of this major private sector provider as a significant blow for all staff involved, both those who have or will lose jobs and those who have had been through the uncertainty of not knowing whether they would retain a job. Stories claiming that some employees had found that they had lost their jobs by phone are upsetting and must be viewed as unacceptable. There will also be knock on effects for suppliers and sub contractors who will potentially lose money. Councils will also experience additional costs either in time and resource spent addressing the problems of losing a partner and contractor, employing alternative firms on short term contracts or re-tendering.

It appears KPMG have been in discussions over contracts with Morgan Sindall, Mears and others whilst not taking the opportunity to enter dialogue with councils. APSE would urge those local authorities with capacity to consider approaching KPMG to see if there is any way they can acquire work. Some of this work can potentially be taken back in house. There will be a requirement to re-tender for this work under OJEU rules. Alternatively work can be shared between partners under existing framework agreements.

Those councils whose contract has been acquired by either Morgan Sindall or Mears are under no obligation to continue with the new owner of the contract if they have a break clause in the event of an administrator being appointed.

Many in the industry are aware of rumours circulating that Connaught's bids for council work were often so called 'suicide' bids and the Norwich City Council housing maintenance contract is a case in point. Norwich councillors and officers had feared that the bid from Connaught of £17.5m was too low and at £5.5m less than a rival bid, a court was persuaded that it was 'abnormally low'. Connaught had claimed they would be able to deliver the service at the lower price because personal computer systems would make for a more efficient model meaning no return to stores to get parts amongst other things. Councillors in Norwich are now admitting that the cost of maintenance would now be far more expensive including re-tendering costs.

It is unlikely that new contracts will be as attractive as those agreed with Connaught as firms look to avoid the pitfalls that Connaught fell into but the economic downturn and desire for

construction firms to acquire work may mitigate this issue and it remains to be seen whether councils will be subject to increased costs.

There are a number of lessons for clients from this episode such as contingency planning, appointment of contractors and tender evaluation. All of these are good practice and should be built into procedures when contracts are awarded

Although there is no current evidence that any other major construction firms will be unable to meet their contractual responsibilities, it is worth bearing in mind that only 4 months ago Connaught was seen as a safe bet by many. The unfortunate circumstances Connaught clients now find themselves in reiterates the importance of having contingency plans in place for all services. This of course is not specific to building maintenance services but it is good practice to spread the load and ensure that in the event of a situation such as this, the council has other providers it can turn to in order to ensure continuity of service.

Officers and councillors at Norwich City Council had raised fears that all was not as clear as it should be when Connaught bid for the recent work there. If it appears that a bid is too good to be true then that is nearly always the case and when difference between 2 bidders is over £5m alarms should start ringing and be acted upon.

Procedures at tender evaluation stage need to be detailed enough to expose any unusual accounting practices, such as capitalisation, which may have a potential impact on the ability of private sector providers to deliver on a contract.

Phil Brennan
Principal Advisor