

The Collapse of Carillion: Regulatory Failure in the Contract State

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ABSTRACT

The rise of the contract state in the UK heralded an era of harnessing the private sector for public purposes. However, the collapse of Carillion, one of the largest contractors with the UK public sector, in 2018 epitomises its failure. Focusing on ex-ante regulatory failure, this essay analyses Carillion's collapse from three perspectives: contract formation in tendering shows that inherent relationality in contracting may lead to an undesirable use of discretion, yet current hard and soft law are unable to structure and confine such discretion; Carillion as a Strategic Supplier shows that the Cabinet Office's design of said programme may fail to monitor participating companies; the management of individual contracts shows both government and companies may be stuck within 'deal-making' and fail to manage risks beyond the contract. It is argued that these perspectives indicate medium to long-term regulatory and institutional failure in government policy-making and enforcement, as well as concerning flaws in Carillion's self-regulation. The sufficiency of ex-post accountability from the executive and legislature is then considered, with Parliament more likely to bring Carillion to account despite the executive often acting as the contractual party. Recommendations are offered, including a public law framework for contracts and common ethical standards.

INTRODUCTION

The rise of the contract state from Margaret Thatcher's 'New Right' government in the 1980s heralded an era of contracting out the delivery of public services. There was the extensive use of market relations, along with market-mimicking techniques such as privatisation and quasi-privatisation.² Such techniques aimed to harness the private sector for public purposes by raising the

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² Christopher Hood, 'A public management for all seasons' (1991) 69 *Pub Admin* 3.

level of competition and bringing in resources and expertise from the private sector. A 'contract culture' hence emerged, denoting the shift to an administrative model mirroring private-sector management, where the relationship between government and private bodies is structured through contracts as opposed to regulations³. However, there were also those who foresaw the failure of this seemingly all-pervasive culture. Potential problems include the corrosion of 'voluntary sector values' such as the provision of socially-beneficial services for non-financial gain, as well as declining service quality and excessive complexity due to increased bureaucracy and legalism.⁴ The collapse of Carillion in 2018, one of the largest contractors with the UK public sector, epitomises such failure.

There is an urgent need to evaluate to what extent Carillion's problems arose particularly to its context or are due to inherent flaws of 'contracting out'. This is mainly due to the 'pyramids'⁵ and 'cascades'⁶ of contract still embedded in the current public/private landscape, with systemic contractual governance at both macro- and micro-levels, spanning from government departments and agencies to private contractors and subcontractors. Given this high level of interconnectivity, Carillion's collapse may have knock-on effects or highlight potential problems with similar contracting processes and contracts concluded with other companies, hence timely analysis is needed to prevent further failures.

Focusing on *ex-ante* regulatory failure, this essay offers analysis on the failure of Carillion from three perspectives: contract formation in tendering shows that inherent relationality in contracting may lead to an undesirable use of discretion, yet current hard and soft law are unable to structure and confine such discretion; Carillion as a Strategic Supplier shows that the Cabinet Office's design of said programme may fail to monitor participating companies; the management of individual contracts shows both government and companies may be stuck within 'deal-making' and hence fail to manage risks beyond the contract. It is argued that these perspectives indicate medium to long-term regulatory and

³ C Harlow and R Rawlings, *Law and Administration* (3rd edn, CUP 2009) 57.

⁴ K Walsh (et al), *Contracting for Change* (OUP 1997) 1.

⁵ M Freedland and D King, 'Contractual governance and illiberal contracts: Some problems of contractualism as an instrument of behaviour management by agencies of government' (2003) 27 *Camb J Econ* 465.

⁶ J Boston, 'The use of contracting in the public sector: Recent New Zealand experience' (1996) 55 *AJPA* 105.

institutional failure in terms of government policy-making and enforcement, while also concerning flaws in Carillion's self-regulation. The sufficiency of *ex-post* accountability from the executive and legislature is then considered, with Parliament more likely to bring Carillion to account despite the executive often acting as the contractual party. This essay comes to the conclusion that recommendations, including a public law framework for contracts and common ethical standards, can address such problems.

THE COLLAPSE OF CARILLION

On 15 January 2018, Carillion, the second-largest construction company in the UK, went into liquidation. The company's share price fell rapidly after issuing a profit warning in July 2016, and this along with an accumulated debt of £1.5 billion led to its collapse.⁷ Carillion held about 450 government contracts involving transport, justice, education and defence, representing £2 billion (38%) of its 2016 reported revenue.⁸ Its financial problems stemmed from cost overruns on 3 public sector construction projects – building the Aberdeen bypass, Midland Metropolitan Hospital, and Royal Liverpool Hospital. Carillion was also highly active in the private sector with operations in Canada, the Caribbean, and the Middle East. It employed around 43,000 staff worldwide, 20,000 of whom were in the UK. With its liquidation, 2,332 job losses have been announced as of 7 June 2018,⁹ and £2 billion is yet to be paid to 30,000 suppliers, sub-contractors and other short-term creditors¹⁰.

⁷ 'Carillion collapse raises job fears' (*BBC News*, 15 January 2018) <<http://www.bbc.co.uk/news/business-42687032>> accessed 8 April 2018.

⁸ Federico Mor and others, 'The collapse of Carillion' (House of Commons Library Briefing Paper, No. 8206, 2018)

⁹ 'Carillion collapse to cost taxpayers £148m' (*BBC News*, 7 June 2018) <<https://www.bbc.co.uk/news/business-44383224>> accessed 9 March 2019.

¹⁰ 'Further 97 Carillion workers lose jobs' (*BBC News*, 3 April 2018) <<http://www.bbc.co.uk/news/topics/cwrlqejqdt/carillion>> accessed 8 April 2018.

EX-ANTE REGULATORY FAILURE

Contract formation – the tendering of Carillion contracts

To understand why Carillion failed to fulfil its contractual obligations, it must first be analysed why government contracts were awarded to the company in the first place. The tendering of contracts over a certain value is governed by the EU procurement regime. The rest are under domestic law where the tendering process is largely controlled by principles-based regulation and formal law plays a relatively limited role. It is argued that despite the EU's best efforts to structure and confine discretion, relational elements still seeped through to influence the awarding of contracts to Carillion. This was further exacerbated by the UK government's use of soft law and focus on 'value for money' ('VFM').

Responding to Carillion's collapse, Bernard Jenkin, the Conservative chairman of the House of Commons Public Administrative Committee, commented that 'Whitehall tends to award contracts to companies it regularly does business with.'¹¹ This failure is highly relevant with Macneil's relational contract theory, which suggests that every single transaction is embedded in complex relations, including those of trust and cooperation.¹² Further elaboration comes from Bradach and Eccles, who argue that decisions on procurement are made less by considering price and more by the construction of relationships through bargaining in networks of social actors.¹³ Linking this back to Whitehall, when successful transactions are regularly carried out between government and a private company, reliability and smooth interactions arise through knowledge of the standards and norms of the other party, creating a positive relationship. This illustrates a protectionist approach, in which Government protects companies with which it has a relationship of trust and confidence. Therefore, in terms of Carillion, with its numerous pre-existing public sector contracts, the awarding of new contracts can be seen as an extension of such protectionist approach.

¹¹ BBC News (n 7).

¹² Ian R Macneil, 'Relational contract theory: challenges and queries' (2000) 94 *NWULR* 877.

¹³ See Jeffrey L Bradach and Robert G Eccles, 'Price, authority and trust: from ideal types to plural forms' in Grahame Thompson and others (eds), *Markets, hierarchies and networks: The coordination of social life* (Sage Publications 1991).

The EU procurement regime aims to ameliorate such a problem, and its application to contracts of higher value allows regulation to be directed precisely to transactions of greater economic importance. In the UK, the 2014 EU Procurement Directives¹⁴ are incorporated into domestic law through the Public Contracts Regulations 2015 ('PCR'). Rule-making thus shifts tendering from Macneil's relational model to a discrete one clearly confined by law and formal communication.¹⁵ This model serves Davis' two purposes of administrative law: structuring and confining discretion.¹⁶

The structuring of discretion can be seen in PCR section 67(3) on contract award criteria which notes that:

- (3) Such criteria may comprise, for example—
- a) quality, including technical merit, aesthetic and functional characteristics, accessibility, design for all users, social, environmental and innovative characteristics and trading and its conditions;
 - b) organisation, qualification and experience of staff assigned to performing the contract, where the quality of the staff assigned can have a significant impact on the level of performance of the contract; or
 - c) after-sales service and technical assistance, delivery conditions such as delivery date, delivery process and delivery period or period of completion.

[...]

The confining of discretion can be found in subsections 9 to 11 on weighting:

“(9) The contracting authority shall specify, in the procurement documents, the relative weighting which it gives to each of the criteria

¹⁴ Including the Public Contracts Directive 2014, the Concessions Contracts Directive 2014, and the Utilities Directive 2014.

¹⁵ Macneil (n 12).

¹⁶ See KC Davis, *Discretionary Justice* (Greenwood Press 1969).

chosen to determine the most economically advantageous tender, except where this is identified on the basis of price alone.

(10) Those weightings may be expressed by providing for a range with an appropriate maximum spread.

(11) Where weighting is not possible for objective reasons, the contracting authority shall indicate the criteria in decreasing order of importance.

However, it is questionable whether rule-making is effective in practice. Given Carillion's size, its largest contracts were often secured under the EU regime, which included the 3 contracts mentioned above: the Aberdeen bypass worth £745 million, the Midland Metropolitan Hospital worth £350 million, and the Royal Liverpool Hospital worth £335 million. Nonetheless, all three suffered from major delays and cost overruns. Moreover, a £280,000 fine was issued on the Aberdeen bypass project for environmental pollution.¹⁷ It is clear from this empirical observation that rule-making alone was insufficient in structuring and confining discretion, and this is also recognised by Goodin – 'rules cannot, at least without substantial costs in other respects, prevent arbitrariness and other vices; for much the same reasons that discretionary decisions display those attributes, rule-based decisions *can*, and probably *will*.'¹⁸

Moreover, failure was further hastened by the use of soft law and focus on VFM in the domestic context. For local government, the Local Government Transparency Code 2015 sets out minimum standards for data publishing, while central government mainly relies on policy commitments and the Transparency Principles. The use of codes, commitments and principles-based regulation in itself assumes a high degree of trust on those being regulated, and trust was already previously established to beget protectionism. However, a discrete model incurs high transaction costs with the need for balancing, notification and justification, and the government's focus on VFM over competition compounds its aversion towards the model. As stated by Davies, through the lens of VFM, any savings made by competition are small, and are potentially outweighed by the costs of

¹⁷ 'Where did it go wrong for Carillion?' (*BBC News*, 15 January 2018) <<http://www.bbc.co.uk/news/business-42666275>> accessed 8 April 2018.

¹⁸ Robert E Goodin, 'Welfare, rights and discretion' (1986) 6(2) OJLS 259.

holding the competition in the first place.¹⁹ At the same time, Sako proposes that trust reduces transaction costs by ‘economis[ing] on the costs of bargaining, monitoring, insurance and dispute settlement.’²⁰ Therefore, in terms of Carillion, the existing 450 contracts with the government themselves convince Whitehall of its competence, so contracts could be ‘safely’ awarded without going through lengthy processes.

To conclude, the tendering of Carillion contracts appears to be a systemic regulatory failure. The use of discretion is varied between different procurement processes, yet inappropriate relationality between contractual parties was still able to influence the outcome.

Contract formation and management – Carillion as a Strategic Supplier

A group of multinational companies – numbering 30 as of January 2019 – with significant contractual relations with the government are named as Strategic Suppliers. They are assigned Crown Representatives (“CRs”) who manage their relationships with the Cabinet Office and assess their performance, and are governed by the Strategic Supplier Risk Management Policy.

Before its liquidation, Carillion was a Strategic Supplier. One week after issuing a profit warning in July 2016 – its third in 5 months – Carillion announced that its joint ventures had been awarded contracts on the HS2 railway project worth £1.4 billion and two further facilities management contracts worth £158 million with the Ministry of Defence.²¹ According to the Risk Management Policy:

3.4 Strategic Suppliers tend by their nature to be large and complex businesses which may operate through or otherwise depend upon a number of trading arms and/or group companies. The Cabinet Office will therefore also monitor publicly available sources for financial information relating to each Strategic Supplier and its group, including in particular information about ‘trigger events’ that could potentially lead to

¹⁹ ACL Davies, *The Public Law of Government Contracts* (OUP 2008) 164.

²⁰ See Mari Sako, *Price, Quality and Trust* (CUP 1992).

²¹ ‘Carillion in ‘high-risk’ contracts row’ (*The Times*, 21 November 2017)

<<https://www.thetimes.co.uk/article/carillion-in-high-risk-contracts-row-l2rvv29hz>> accessed 8 April 2018.

the invocation of financial distress measures in Government contracts. These include:

3.4.3 the issue by the Strategic Supplier or any guarantor of its obligations of a *profits warning* to a stock exchange; [emphasis added]

[...]

5.1 A Strategic Supplier may be designated as ‘High Risk’ on the basis that:

[...]

5.1.2 one or more of the triggers for financial distress listed in paragraph 3.4 above have occurred.

[...]

6.2 Designation as a “High Risk” Strategic Supplier on the grounds of under-performance will have the following additional consequences for the period of the designation:

[...]

6.2.4 In-Scope Organisations should reduce where possible the extent to which the Strategic Supplier is given additional work under the terms of an existing contract (by, for example the exercise of any option or change requests) so as to contain the risk to the taxpayer.

Given such provisions, it is submitted that Carillion should not have been awarded new contracts after issuing multiple profit warnings; given its status as a Strategic Supplier, it should have been monitored more closely for the management of existing contracts as well. Three issues related to the administrative law ‘TAP values’ – transparency, accountability, participation – ²² have been identified as leading to the failure, including the lack of transparency in

²² Carol Harlow (2017), ‘TAP values’. Lecture retrieved from <http://moodle.lse.ac.uk>.

designating Strategic Suppliers as ‘High Risk’, CRs’ potential conflicts of interest, and the lack of participation of interested parties outside government.

Firstly, there is a lack of transparency on the decision-making process. As noted in paragraph 5.1 of the Risk Management Policy, a Strategic Supplier ‘may’ be designated as High Risk if one or more triggers have occurred, while ‘all the relevant circumstances’ should be considered, including public service delivery, financial and reputational consequences for the government. From paragraph 7.1, the main decision-maker is the Commercial Relationships Board, which considers whether grounds exist for recommending to the Minister for the Cabinet Office that the Strategic Supplier be designated as ‘High Risk’. If so, a dialogue ensues between the Board, Strategic Supplier and Minister, with the Strategic Supplier having the chance to make written representations before the final decision is made. The criteria for consideration are rather vague, and the whole process is limited to the government and the Strategic Supplier – there are no provisions on having the decision reviewed by a third party, or having the reasons for designating ‘High Risk’ (or not) published. As a result, transparency and accountability are sorely lacking. This is particularly problematic given that any consideration of ‘High Risk’ entails that large companies are facing financial troubles or are at the brink of collapse.

Secondly, there is the potential conflict of interest of CRs themselves. CRs are responsible for initiating the process of ‘High Risk’ designation, conducting quarterly reviews, and determining whether a recommendation should be made to the Commercial Relationships Board. However, they are often chosen from the same industry as the Strategic Supplier. This can lead to problems of back-scratching: Labour Party research shows that several CRs hold external directorships.²³ As it was presented by an opposition party, the research and its conclusions must be considered relatively cautiously, but their potential truthfulness should not be denied. Therefore, there is again a lack of transparency on how CRs are chosen and subsequently monitored, considering their

²³ ‘Labour alleges conflict of interest in oversight of private suppliers’ (*The Guardian*, 21 January 2018) <<https://www.theguardian.com/business/2018/jan/21/conflict-of-interests-rampant-in-firms-such-as-carillion-warns-labour>> accessed 8 April 2018.

importance in the day-to-day interactions between government and Strategic Suppliers.

Finally, there is a lack of participation of interested parties from outside government. The determination of 'High Risk' status is a matter only between the Cabinet Office and Strategic Supplier. Under paragraph 6.4 of the Risk Management Policy, the decision to designate 'High Risk' is not disclosed to the public, but only to CRs and In-Scope Organisations, which includes departments, executive agencies and relevant Non-Departmental Public Bodies. With the former, interested but excluded parties such as subcontractors were unable to inform the government of Carillion's potential risks, for example increasing payment terms from 30 to 120 days to help with cashflow.²⁴ With the latter, the parties themselves were also uninformed about the full extent of Carillion's problems; this resulted in a failure to reduce or stop doing business with Carillion, thus increasing the current amount owed to them. Therefore, a lack of participation may have led to poor decision-making by both the government and outside parties.

To conclude, despite the status of Strategic Supplier bringing the expectation of greater scrutiny, such a relationship with the Cabinet Office may actually have allowed more problems to slip through the cracks, thus there would appear to be an institutional failure.

Contract management – individual contracts

According to 'A Short Guide to Commercial Relationships' published by the National Audit Office, government institutions retain responsibility for the services they contract out, and the contract is the principal mechanism for them to ensure that standards expected of public services are met.²⁵ However, other factors beyond government contracts can also affect service provision and quality, and the failure to take three of such factors into account and manage them effectively led to Carillion's collapse. They include projects beyond those with the UK government, corporate culture, and secrecy of individual contract details. This argument is based on the problem of 'deal-making' identified by Johns when

²⁴ 'Carillion 'aggressively managed' accounts, report says' (*BBC News*, 4 March 2018) <<http://www.bbc.co.uk/news/business-43275605>> accessed 8 April 2018.

²⁵ National Audit Office, 'A Short Guide to Commercial Relationships' (NAO 2017).

financing is used as a method of governance – the deal becomes standalone, set apart from its wider considerations and circumstances.²⁶

Firstly, Carillion's work was not limited to public sector projects with the UK government. It had large private projects within the UK such as the Liverpool FC Anfield Stadium expansion, as well as overseas projects in Canada, the Caribbean and the Middle East. Its collapse was partly caused by taking on too many risky projects which proved unprofitable, particularly those in the Middle East, with which it faced significant payment delays.²⁷ From Carillion's 2016 annual report, 15% of total group revenue originated from the Middle East and North Africa, totalling £786 million.²⁸ Therefore, the success or failure of Carillion's numerous other projects could easily have affected the performance of its government contracts in terms of cashflow, manpower and materials, and thus should have been constantly monitored.

Secondly, Carillion's corporate culture outside its relationship with the government was also highly influential to decision-making, and yet was not adequately monitored. One aspect is excessive executive remuneration. For example, former CEO Richard Howson, who left Carillion in July 2017, would have continued to receive a £660,000 salary and £28,000 in benefits until October 2018, despite the company issuing multiple profit warnings during his tenure.²⁹ A relaxation of clawback conditions on executive pay was also instituted in 2016.³⁰ Although the UK government has announced that none of Carillion's directors and members of senior management would be receiving any bonuses or severance payments,³¹ it is submitted that such rewards independent of performance would have influenced their behaviour prior to the company's collapse. This behaviour included taking on further debt to compensate for a failure to turn reported

²⁶ Fleur Johns, 'Financing as governance' (2011) 31(2) OJLS 391.

²⁷ BBC News, 'Where did it go wrong for Carillion?' (n 17).

²⁸ Carillion plc, 'Annual Report and Accounts 2016' (Carillion 2016).

²⁹ 'Carillion: Six charts that explain what happened' (BBC News, 19 January 2018) <<http://www.bbc.co.uk/news/uk-42731762>> accessed 8 April 2018.

³⁰ 'Carillion bosses face inquiry after protecting "exorbitant" £4 million bonuses ahead of collapse' (*Independent*, 15 January 2018) <<https://www.independent.co.uk/news/uk/politics/carillion-collapse-bonuses-investigation-inquiry-liquidation-government-outsourcing-a8160946.html>> accessed 8 April 2018.

³¹ *Ibid.*

profits into cash, and aggressively managing the company's balance sheet to enhance reported profitability and net debt position.³² The lack of government monitoring of such a culture can be seen through the National Audit Office's 'Good Practice Contract Management Framework', which provides good practice standards in eleven areas for the management of service contracts by central government.³³ In the 'people' area, standards are limited to ensuring the capability of those working in government and the relationship between the government and the contracted company, without also scrutinising the company's employees and internal processes.

Finally, the secrecy of individual contract details also hinders contract management, albeit from the different perspective of third-party scrutiny. As contracts often list detailed spending commitments and objectives, publishing such details would allow interested external parties to assist in maintaining service provision standards through public pressure and share price movement. The National Audit Office expects all government contracts to be publicly available as legal and policy commitments, but observes that most are either unpublished or severely redacted.³⁴ It is submitted that a balance needs to be struck between these two positions. A certain extent of redaction is necessary in practice, as much of the content within the contracts would be commercially sensitive from the tenders and negotiations made. However, budgets, objectives, and deadlines of Carillion contracts could have been published for external reference and scrutiny, and the failure to do so again exacerbated the fallout from its collapse.

To conclude, the inability to anticipate and manage problems specific to a company but outside of government contracts appears to be a failure of both government policy-making and enforcement, as well as Carillion's self-regulation.

³² BBC News, 'Carillion "aggressively managed" accounts, report says' (n 24).

³³ National Audit Office, 'Good Practice Contract Management Framework' (NAO 2016).

³⁴ National Audit Office, 'A Short Guide' (n 25).

SUFFICIENCY OF *EX-POST* ACCOUNTABILITY

Executive

Despite Carillion's size and number of employees, the government did not feel it was 'too big to fail', declining to step in and save the company. Cabinet Office Minister David Lidington defended that 'taxpayers cannot be expected to bail out a private sector company...or allow rewards for failure', and that Carillion's shareholders and lenders would bear the 'brunt of the losses'.³⁵ This response, along with denying payments to Carillion's senior officers, seem ostensibly in line with the 'Macrory penalties principles', with the former aiming to deter future poor behaviour by other firms, and the latter eliminating any financial gain or benefit from current poor behaviour.³⁶ However, one must note that awarding new contracts to Carillion when it was already in dire financial straits could also be seen as another form of attempting to bail the company out. According to industry sources, had the company not been awarded the new HS2 and Ministry of Defence contracts in July 2017, Carillion would have gone into liquidation months earlier.³⁷

Moreover, on 3 February 2018, the government announced it would provide funding to maintain Carillion's public sector projects in the wake of its collapse, and government-backed loans totalling £100 million would be available to suppliers and sub-contractors affected.³⁸ This suggests that in the end, the cost of public sector projects is still borne by the public. This can be reflected from a comment in the Transport Committee's report on passenger rail franchising – another debacle which suffered from overwhelming complexity, cost overruns and poor service. '[The government] wants risk to be transferred from the public to the private sector, and yet risk cannot be transferred in anything other than

³⁵ 'Carillion collapse: Cabinet Office minister David Lidington says "vital services" will be kept afloat - but this is no bail out' (*City AM*, 15 January 2018) <<http://www.cityam.com/278815/carillion-collapse-cabinet-office-minister-david-lidington>> accessed 8 April 2018.

³⁶ Richard B Macrory, 'Regulatory Justice: Making Sanctions Effective' (Cabinet Office 2006) (Macrory Report).

³⁷ BBC News, 'Carillion collapse raises job fears' (n 5).

³⁸ 'Carillion collapse: UK puts up £100m to back Carillion contractor loans' (*BBC News*, 3 February 2018) <<http://www.bbc.co.uk/news/business-42925155>> accessed 8 April 2018.

name because, as everyone knows, no Government could afford to let the railways go bust.³⁹ Therefore, the original purpose of contracting out as the transfer of risks and costs from government to companies is turned on its head. Financial accountability from Carillion which can be demanded by the executive appears limited.

Legislature

On 24 January 2018, the Work and Pensions Committee and Business Energy and Industrial Strategy Committee announced a joint inquiry into the collapse of Carillion. By 6 February 2018, the co-chairs of the Work and Pensions Committee had issued a joint statement reprimanding former Carillion directors for passing the blame during oral evidence sessions.⁴⁰ Assessing such action by the Howe criteria,⁴¹ the prompt response by Parliament and the strong criticism of Carillion management arguably achieve three objectives. Firstly, to provide catharsis for stakeholders (Howe Criterion 3); secondly, to reassure the public that the government was taking the matter seriously (Howe Criterion 4); and, thirdly, to serve the political interests of government by blaming Carillion from the start (Howe Criterion 6), thus shifting the focus away from the fact that the government the counterparty of many of Carillion's contracts and had probably failed to carry out effective contract management themselves, as argued above.

Moreover, by 4 March 2018, the Select Committees had published a series of findings indicating 'pervasive institutional failings'.⁴² They include how Carillion's accounts were found to be irregular by the new Chief Financial Officer who started in September 2017, how a presentation had been made to Carillion executives by audit firm Ernst & Young commenting on the culture of non-compliance and a lack of professionalism and expertise, and an independent business review commissioned in 2017 which Carillion had refused to publish as

³⁹ Transport Committee, *Passenger Rail Franchising* (HC 2005-06, HC 1354), 7.

⁴⁰ 'Carillion: Ex-chairman Philip Green takes blame for collapse' (*BBC News*, 6 February 2018) <<http://www.bbc.co.uk/news/business-42958507>> accessed 8 April 2018.

⁴¹ See Geoffrey Howe, 'The management of public inquiries' (1999) 70 *Pol Q* 294. The six criteria will be cited hereafter as Howe Criteria 1 through 6.

⁴² 'Carillion board papers reveal "pervasive institutional failings"' (*UK Parliament*, 2 March 2018) <<https://www.parliament.uk/business/committees/committees-a-z/commons-select/work-and-pensions-committee/news-parliament-2017/carillion-board-papers-17-19/>> accessed 8 April 2018.

it was deemed to be ‘too harsh’.⁴³ Put together, these serve to establish the facts of Carillion’s medium to long-term failure (Howe Criterion 1). However, with the inquiry still in early stages, it is too early to examine whether it has allowed different parties to learn from events (Howe Criterion 2), or whether people and organizations will be made accountable (Howe Criterion 5). Therefore, whether political accountability from Carillion will be sufficient is yet to be determined. It is ironic to note that Parliament may do better than the executive at bringing Carillion to account, despite the fact that it was the latter which entered into the contracts in the first place.

REFORM PROPOSALS

With regulatory failure including Carillion-specific problems and also problems inherent to contracting out, recommendations made should be able to address both. Two recommendations will be submitted below. Firstly, modelling on Davies’ *Accountability: A Public Law Analysis of Government by Contract*, a public law normative framework for contracts should be created.⁴⁴ Secondly, building on proposals from the Committee on Standards in Public Life, common ethical standards for service providers should be established.⁴⁵

Public law normative framework for external contracts

In her book, Davies proposes a ‘public law of internal contracts’, where non-legally binding agreements between public bodies are used as mechanisms of accountability with the introduction of new norms.⁴⁶ Such a proposal can possibly be extended to external contracts with private firms as well, which was mentioned by her as a concluding thought and will be explored here.

Davies sees contractualisation itself as a success, with a public law normative framework further enhancing its positive effects for internal

⁴³ BBC News, ‘Carillion “aggressively managed” accounts, report says’ (n 24).

⁴⁴ Anne Davies, *Accountability: A Public Law Analysis of Government by Contract* (OUP 2001).

⁴⁵ Sheila Drew Smith, ‘The Collapse of Carillion - a Failure of Ethical Standards?’ (Committee on Standards in Public Life, 1 February 2018).

⁴⁶ Davies (n 44).

contracts.⁴⁷ It is argued that this view is compatible with the analysis of external contracts previously made by this essay. First, despite fixed-price contract bidding being seen as sub-optimal as it fundamentally awards low bidders at the possible expense of service quality,⁴⁸ statistics from the Smith Institute show that in reality contracts are almost always fulfilled to a satisfactory degree.⁴⁹ Thus, contracting out is still a desirable tool for the state, and the introduction of new norms can potentially improve the process by reducing the inherent flaws found in contract formation and management. For example, relevant norms include debating the practicalities of achieving particular targets,⁵⁰ which tackles the problem of firms submitting overly low bids and government focus on VFM at the procurement stage. Another norm involves the purchaser considering the interaction between its contract and other accountability processes applicable to the provider,⁵¹ which reduces the problem of ‘deal-making’. Therefore, if successful, this solution may reduce the flaws in the tendering of Carillion contracts and the management of individual contracts.

Common ethical standards for service providers

Following Carillion’s collapse, the Committee on Standards in Public Life proposed a code of conduct delineating common ethical standards for all companies providing public services.⁵² Revolving around the ‘Nolan principles’ of selflessness, integrity, objectivity, accountability, openness, honesty and leadership,⁵³ such a code of conduct would also be a form of principles-based regulation, the use of which was criticised above as problematic. However, as Black has observed, principles-based regulation is not necessarily undesirable in itself,⁵⁴ but simply ‘does not work with people who have no principles’.⁵⁵

⁴⁷ Ibid.

⁴⁸ Peter Vincent-Jones, *The New Public Contracting* (OUP 2006) 194.

⁴⁹ Denise Chevin (ed), *Public Sector Procurement and the Public Interest* (Smith Institute 2005)

⁵⁰ Davies (n 44).

⁵¹ Ibid.

⁵² Smith, ‘The Collapse of Carillion’ (n 45).

⁵³ Cabinet Office, *First Report of the Committee on Standards in Public Life* (Cm 2850-I, 1995) (Nolan Report).

⁵⁴ Julia Black, ‘Paradoxes and Failures: ‘New Governance’ Techniques and the Financial Crisis’ (2012) 75(6) MLR 1037.

⁵⁵ Hector Sants, ‘Delivering Intensive Supervision and Credible Deterrence’ (Reuters Newsmakers, London, 12 Mar 2009).

Therefore, the Nolan principles bring an additional difference of changing fundamental workplace culture to instil respect for principles, which is argued by Goodin as giving the best chances of bringing true administrative change.⁵⁶ This solves the discrepancy between Davis' theory of structuring and confining discretion, and the reality of poor decision-making in the tendering of Carillion contracts.

Such standards can also be applied to reduce the problems in Carillion's status as a Strategic Supplier. The aggressive management of Carillion's accounts and concealment of negative independent reports indicate a disregard of integrity and honesty across the firm. Similarly, excessive executive pay and relaxed clawback conditions reduced accountability at Carillion's management level. Moreover, the avoidance of responsibility by directors post-collapse shows a lack of leadership and selflessness. To address such inadequacies, per the Committee's 2014 report on Ethical Standards for Public Service Providers, a strategic programme can be adopted by the Cabinet Office, requiring CRs to maintain high ethical standards in their relationships with Strategic Suppliers.⁵⁷ Therefore, common ethical standards also allow the Strategic Supplier programme to bring more benefits than harms.

In the larger context, the contract state is most likely here to stay for the near future, given the UK's ongoing austerity programme and the current administration's small-government approach maintaining the need to delegate public services to third parties. However, from the two aforementioned recommendations it is clear that a complete overhaul of the system is unnecessary, and instilling fundamental mentalities within the existing structure can be equally effective. Ultimately, the goal is to achieve a balance between regulation and discretion, and consistency and individuation. Too much flexibility may sanction excessive discretion and creative compliance, but too much regulation may deter small businesses from participating, which can cause a lack of competition. Such a goal can arguably be met through continuing the distinction between the use of more stringent regulations with larger contracts, where stakes are relatively

⁵⁶ Peter Hupe and Michael Hill, 'Street-level bureaucracy and public accountability' (2007) 85 *Pub Admin* 279.

⁵⁷ Committee on Standards in Public Life, *Ethical Standards for Public Service Providers* (Cabinet Office 2014).

higher, and soft law and principles-based regulation with smaller deals. Where hard rules are imposed, there should be less reluctance to punish poor performance or non-compliance for the sake of maintaining a good relationship with the supplier, with the ‘balance to be struck between partnering and contract management and enforcement’⁵⁸ leaning more towards regulation and consistency. When soft law is used, the greater degree of discretion and individuation can be tempered by stressing the importance of good practice and ingraining norms into the workplace culture. Therefore, such changes in mentality through the recommendations offered may lead to less failures and greater accountability in the broader public/private landscape.

CONCLUSION

This essay has identified and analysed the main regulatory flaws leading to the collapse of Carillion. From relationality affecting contract formation, to the absence of TAP values in the management of Strategic Suppliers, to wilful blindness in the deal-making mindset, it is submitted that such flaws are a mixture of those inherent to the contracting out process and those specific to Carillion’s situation. As accountability mechanisms have yet to run their course, it is unclear whether Carillion, in the form of its management, will ultimately bear its proportionate responsibilities. Nonetheless, further steps should still be taken. Recommendations include a public law of external contracts, and common ethical standards for service providers, both of which target the three flaws mentioned above and have greater implications in achieving a balance between rules and discretion within the larger context. With further research on how these recommendations can be properly incorporated, one company’s collapse may bring the future reinforcement of the contract state framework.

⁵⁸ HM Treasury, *PFI: Strengthening long-term partnerships* (HM Treasury 2006).