

Dealing with the risk of fraud in private and public sector contracts

12 May 2020

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Disclaimer

- **The material in these notes is based upon the law of England and Wales, as at 12 May 2020.**
- **This material is only intended to provoke and stimulate. It does not constitute legal advice.**
- **Detailed professional advice should be obtained before taking or refraining from taking any action in relation to this material.**

The Government's brief for public authorities

- Policy of public authorities supporting suppliers and contractors facing hardship due to COVID-19
- Aim of avoiding longer term service disruptions and to support employees, sub-contractors and supply chain
- Public authorities to ensure prompt payment and consider advance payment requests
- Relaxation of contractual milestones, timescales, KPIs and SLRs

Main sources of guidance – 1

- ‘Procurement Policy Note 01/20 - Responding to COVID-19’ (“**PPN 01/20**”) – 18 March 2020
- ‘Procurement Policy Note 02/20 – Supplier relief due to COVID-19’ (“**PPN 02/20**”) – 20 March 2020
- ‘Fraud Control in Emergency Management: COVID-19 UK Government Guidance’ – 26 March 2020

Main sources of guidance – 2

- ‘Guidance notes on Model Interim Payment Terms - PPN 02/20’ – 6 April 2020
- ‘Guidance Notes for Construction Contracts - PPN 02/20’ – 6 April 2020
- ‘Frequently Asked Questions (FAQs) - Procurement Policy Note 02/20’ – 6 April 2020 (updated 17 April)

Status of guidance documents

- PPNs are routinely used to provide instructions to public authorities
- PPN 01/20, PPN 02/20 and related guidance issued by Cabinet Office
- Not strictly binding, but general duties to take into account as relevant considerations and to act consistently with published policy
- Good reasons needed where not followed and best if documented – risk of challenge by judicial review

Heightened risk of fraud



Image from <https://www.thedigitaltransformationpeople.com>

Types of fraud risk

(1) First party application fraud

- Underperforming suppliers or contractors likely to make payment requests
- They will secure funds absent careful vetting and given accelerated processing by public authorities

(2) Third party impersonation fraud

- Heightened demand for certain services and equipment in crisis response
- Concern where public authorities are required to work with new providers instead of trusted suppliers

Key anti-fraud features of PPN

02/20

- **‘Open Book’ approach:** suppliers and contractors to allow access to “any data, including from ledgers, cash-flow forecasts, balance sheets, and profit and loss accounts, as required and requested to demonstrate the payments made ... have been used in the manner intended.”
- Further specification:
 - Model Interim Payment Terms - definition of ‘Open Book Interim Data’
 - NEC3 model clause Z2.1 and JCT model clause 10.1

Key anti-fraud features of PPN

02/20

- Integrating fraud control personnel into the policy and process design
- Low-friction counter measures
- Post-event assurance checks
- Keep under review distinction between emergency payments and longer term services
- Amending contracts with existing trusted suppliers

Dealing with the risk of fraud in private and public sector contracts: contractual provisions

Marion Smith QC

PPN 02/20: Transparency

- Work collaboratively to ensure transparency
- Demonstrate payments used in the manner intended e.g. staff paid right amount and on time, cash flows through the supply chain as quickly as possible
- CA keep records of decisions and agreements
- No expectation of making profits on undelivered contract elements
- All suppliers to operate with integrity
- Action to recover payments from suppliers taking undue advantage, or failing to act transparently and with integrity

Model Terms: Construction Contracts

- Model Deeds of Variation, NEC3 and JCT
- Consider existing bespoke amendments to the underlying contract
- NEC3 and JCT Recital B: act in good faith and work together towards the aims and principles set out in PPN 02/20

NEC3 Model Deed: Z2

Z2.1: Open Book Reporting

Z2.2: Payment during COVID Relief Period

Z2.3: Recovery of payments by Employer

Z2.4: Warranties

Z2.5: Payments

NEC3 Model Deed: Z2.1.2

Ensure that the payments made by the *Employer* as a COVID relief **are promptly and solely applied to the purposes for which they are made** including payments to *key persons* and/or Subcontractors;



Z2.1.6: “act transparently and with integrity and **at all times in good faith and **using best endeavours in relation to any COVID Relief**”**

Image from <http://theipanalysts.com>

NEC3 Model Deed: Z2.2

“... , the *Contractor* shall (1) not be entitled to combine and shall procure that the *key persons* shall not combine any COVID Relief provided pursuant to this Deed or otherwise with (2) any Government COVID-19 related relief, grant, intervention or other measure (3) which results in the *Contractor* and/or *key persons* and/or Subcontractors receiving relief (4) more than once for the same underlying cashflow issue (5) which in the reasonable opinion of the Employer (6) ~~would amount to the Supplier taking undue advantage of any COVID Relief which in the reasonable opinion of the Employer~~ (7) would amount to the Contractor and/or *key persons* and/or Subcontractors taking undue advantage of any COVID Relief.”

NEC3 Model Deed: Z2.3 Pt 1

Z2.3 If the *Contractor*:

Z2.3.1 **(1)** fails to comply with the provisions of any of this clause Z.2; **(2)** and/or

Z2.3.2 *key persons* and/or Subcontractors **(3)** in the *Employer's* opinion **(4)** takes undue advantage of any COVID Relief; and/or

Z2.3.3 **(5)** has failed to expend any COVID Relief for the intended purpose **(6)** (or as agreed by the *Employer*)

NEC3 Model Deed: Z2.3 Pt 2

the *Employer* shall be entitled to, **(1)** without limitation, **(2)** retain or set-off the Reconciled Value from any amount due and/or outstanding to the *Contractor* **(3)** under this Deed **(4)** or any other contract and/or **(5)** recover the Reconciled Value from the *Contractor* as a debt due and payable by the *Contractor* to the *Employer* and **(6)** the Reconciled Value shall be deducted from the Prices.

JCT: Clause 10.2

During the COVID Relief Period, the Contractor shall **(1)** not be entitled to combine and shall procure that the Contractor's Persons shall not combine any COVID Relief provided pursuant to this Contract or otherwise with **(2)** any Government COVID-19 related relief, grant, intervention or other measure **(3)** which results in the Contractor and/or the Contractor's Persons **(4)** receiving relief twice for the same underlying cashflow issue **(5)** which in the reasonable opinion of the Employer **(6)** would amount to the Contractor and/or Contractor's Persons taking undue advantage of a COVID Relief

Model Interim Payment Terms: Structure

Heading

Clause 1

Clauses 2 – 4: Background

Clauses 5 – 7 : Variation

Clauses 8 – 11: Miscellaneous

Model Interim Payment Terms: Clause 2

“(1) The purpose of this Variation is for the Authority to give relief to the Supplier on the terms of this Variation. (2) The Authority and the Supplier acknowledge that the relief is given in accordance with the policy set out in PPN 02/20 and (3) that both parties shall act in good faith and work together towards the principles set out in PPN 02/20. (4) The Supplier acknowledges that any relief given to it is at the sole discretion of the Authority.”

Model Interim Payment Terms: Clause 6.5

Supplier shall

“ensure that the payments agreed under the Interim Payment Proposal are (1) promptly and solely applied to the purposes for which they are paid, (2) which may include (3) payments to [Supplier Staff] and (4) the Supplier’s Contract supply chain; who are working on deliverables to be provided under or in connection with the Contract so as to reduce the adverse effect of Covid Related Hardship;”

Model Interim Payment Terms: Clause 6.6

Supplier shall not be entitled,

- To include any profit
- To include any payments where there is no contractual volume commitment
- To any payments to extent underperforming
- To combine, “*which results in the Supplier receiving more than one benefit/relief*”

Model Interim Payment Terms: Clause 7 Pt 1

“If, in **(1)** the reasonable opinion of the Authority, the Supplier:

7.1. fails to meet any obligation set out in this Variation;

7.2. receives any payment and fails to apply it to meet any proposal in the relevant Interim Payment Proposal;

7.3. takes undue advantage of any relief; or

7.4. fails to act transparently and with integrity,”

Model Interim Payment Terms: Clause 7 Pt 2

“the Authority may take (1) all action necessary to recover any payments made to the Supplier during the relevant Covid Relief Period, (2) including without limitation (3) retaining or setting-off payment of (4) any amount it owes to the Supplier (5) at any time (6) under this Contract or any other contract, (7) to the extent that sub-paragraphs 7.1 – 7.4 apply to such

Dealing with the risk of fraud in private and public sector contracts: Public Law Issues

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Amendments to Existing Contracts

- Procurement rules in Public Contracts Regulations 2015 continue to apply
- Provision to modify contracts in regulation 72 PCR – limited to specified circumstances
- May satisfy more than one criteria in regulation 72

Amendments to protect against fraud: potential routes

- 72(1)(a) where the modifications, irrespective of their monetary value, have been provided for in the initial procurement documents in clear, precise and unequivocal review clauses, which may include price revision clauses or options, provided that such clauses—
 - (i) state the scope and nature of possible modifications or options as well as the conditions under which they may be used, and
 - (ii) do not provide for modifications or options that would alter the overall nature of the contract or the framework agreement;

- 72(1)(b) for additional works, services or supplies by the original contractor that have become necessary and were not included in the initial procurement, where a change of contractor—
 - (i) cannot be made for economic or technical reasons such as requirements of interchangeability or interoperability with existing equipment, services or installations procured under the initial procurement, [and]¹
 - (ii) would cause significant inconvenience or substantial duplication of costs for the contracting authority, provided that any increase in price does not exceed 50% of the value of the original contract.

- 72(1)(c) where all of the following conditions are fulfilled:—
 - (i) the need for modification has been brought about by circumstances which a diligent contracting authority could not have foreseen;
 - (ii) the modification does not alter the overall nature of the contract;
 - (iii) any increase in price does not exceed 50% of the value of the original contract or framework agreement.

- 72(1)(e) where the modifications, irrespective of their value, are not substantial within the meaning of paragraph (8);
- 72(8): definition of substantial (not reproduced in full here).
 - Agreement becomes materially different
 - Had the modification been part of original procurement, it would have allowed for admission of other candidates; allowed for the acceptance of a tender other than that originally accepted or attracted additional participants
 - Modification changes economic balance in favour of contractor

Remedies for breach of PCR regulation 72

- Declaration of ineffectiveness
- Damages
- Potential Judicial Review and set aside

Exclusion from Future Procurement

- FAQs on PPN 02/20 warn that fraudulent claims under COVID-19 support funds may lead to exclusion from future procurement competitions
- See PCR regulation 57(8)(c)
- Discretion to exclude bidders from participating in a procurement process where the contracting authority can demonstrate that the bidder is guilty of grave professional misconduct, which renders its integrity questionable

Professional Misconduct

- Not limited to the standards of the profession to which the bidder belongs. Can include other wrongful conduct.
- *Conorzio Nazionale Servizi Società Cooperativa (CNS) v Gruppo Torinese Trasporti Gtt SpA* Case C-425/18: breach of competition law. Fact of breach not enough – need to individually consider the conduct.
- Query at what stage you can exclude: *Ryhurst v Whittington Health NHS Trust* [2020] EWHC 448 (TCC)

Other Public Law Risks

- JR Risk: *Mauritius v CT Power Limited* [2019] UKPC 27
- Public law applies to negotiation of commercial agreements by a public body (see judgment para 64)
- Wide margin of discretion and successful challenge likely to require evidence of fraud, corruption or bad faith
- Not an abuse of process to bring judicial review proceedings and civil claim for damages in respect of the same decision

Q&A session

Thank you for your
attention!

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