



National Audit Office

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## **Report**

by the Comptroller  
and Auditor General

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**Department for Business, Energy & Industrial Strategy**

# The Nuclear Decommissioning Authority's Magnox contract

## What this report is about

**1** In 2005, the Nuclear Decommissioning Authority (NDA) was established as a non-departmental public body under the Energy Act 2004. Sponsored by the Department for Business, Energy & Industrial Strategy (the Department), the NDA is responsible for the operation, decommissioning and clean-up of 17 nuclear reactor and research sites in the UK.

**2** Between 2012 and 2014, the NDA ran a competitive procurement exercise for services to decommission two nuclear research sites and 10 Magnox sites. The latter comprise power stations that were at, or nearing, the end of their operational life. With an estimated value of up to £6.2 billion, the 'Magnox contract' is among the largest by value put out to tender by HM Government.

**3** In September 2014, the NDA awarded the 14-year Magnox contract to Cavendish Fluor Partnership (CFP). Energy Solutions, part of a consortium that bid for the contract but lost, lodged legal claims against the NDA. In July 2016, the High Court ruled that the NDA had wrongly decided the outcome of the procurement process. Following this ruling, Bechtel, the partner of Energy Solutions in the consortium, also launched proceedings against the NDA. In March 2017, the Secretary of State for Business, Energy & Industrial Strategy announced that the NDA had agreed settlements with Energy Solutions and Bechtel totalling £97.3 million. He also announced that the NDA had decided to terminate the contract with CFP nine years early due to a "significant mismatch" between the work specified in the tendered contract and the work that needs to be done. **Figure 1** on pages 6 and 7 summarises the main events.

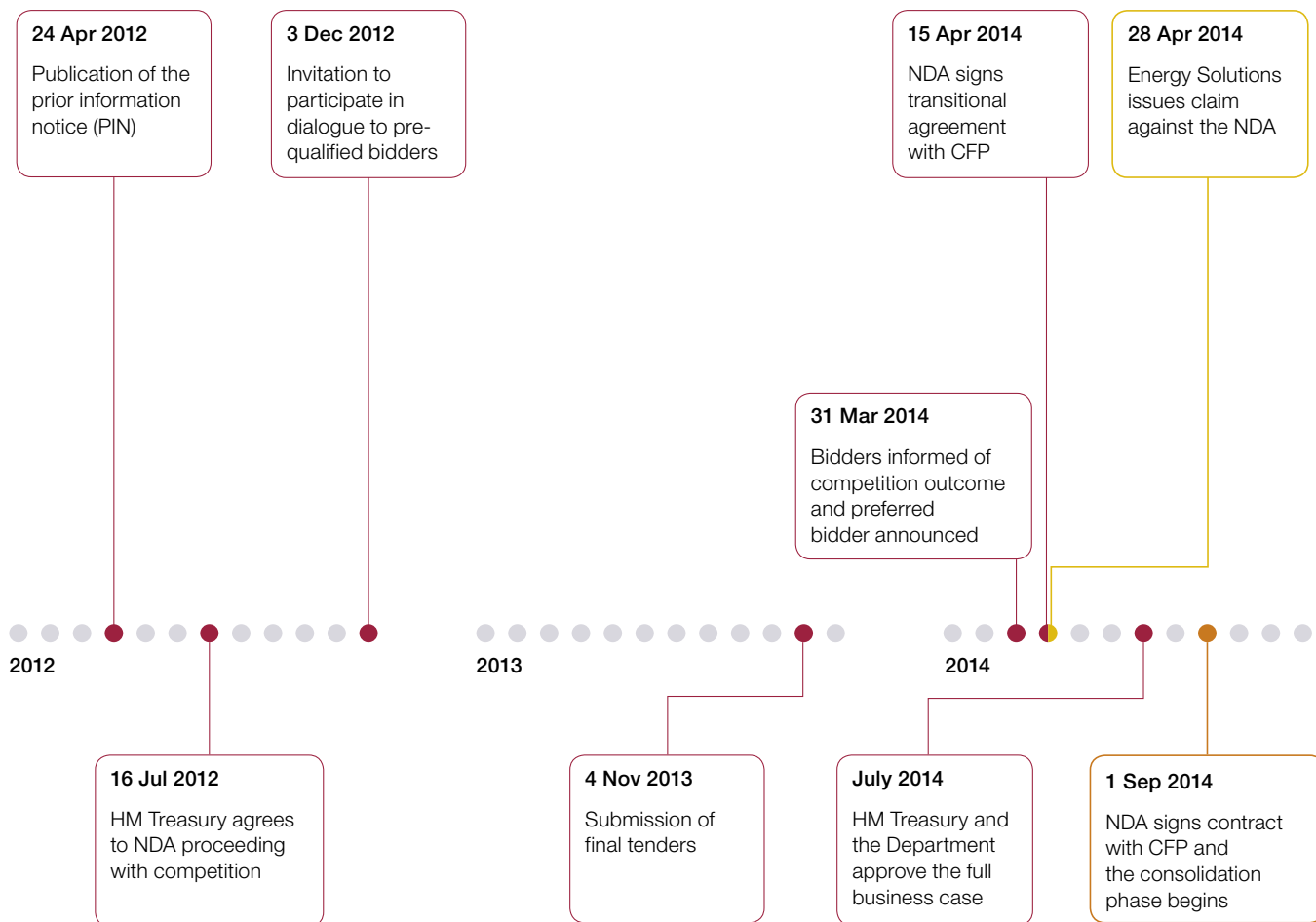
**4** The government has launched an independent inquiry into these events. The inquiry is tasked with establishing the root causes of the defective procurement and identifying lessons. It is expected to report to the Secretary of State in early 2018.

**5** This report is intended to support the Committee of Public Accounts' consideration of the events surrounding the Magnox contract. It sets out the key facts relating to:

- the procurement process, the award, consolidation and termination of the contract, and the NDA's settlement of legal claims (Parts One and Two);
- the governance and oversight arrangements (Part Three); and
- the costs to the taxpayer (Part Four).

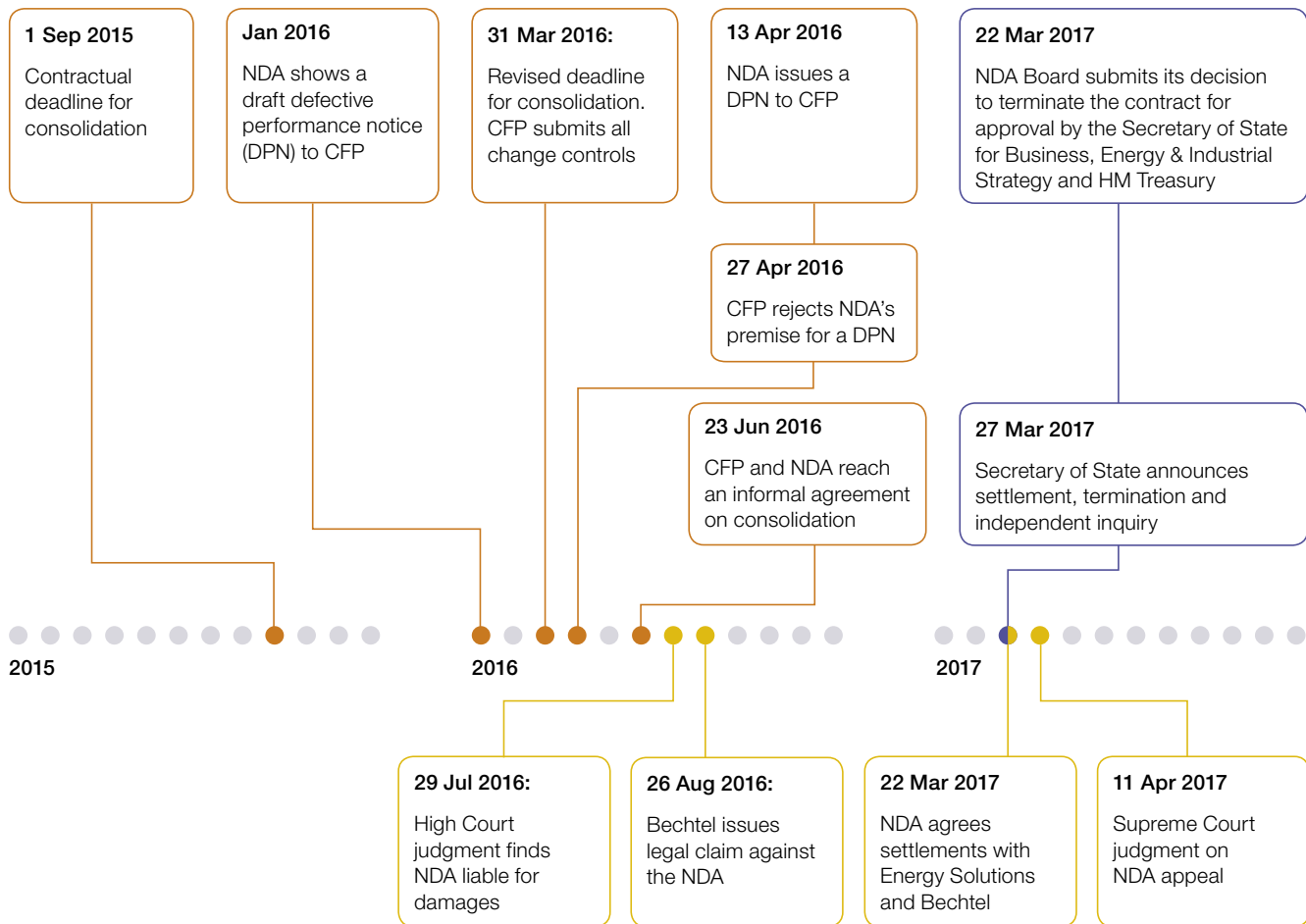
This report does not assess the design of the contract, NDA's compliance with procurement regulations or the reasons behind the High Court judgment. Our approach is set out in Appendix One.

**Figure 1**  
Timeline of key events in the Magnox contract



- Contract competition and award
- Events relating to litigation
- Consolidation phase
- Contract termination

Source: National Audit Office analysis



# Summary

## Key findings

The Magnox procurement, litigation and settlement

**1 The Nuclear Decommissioning Authority (NDA) ran a competitive procurement exercise for decommissioning services at 12 nuclear sites, resulting in the award of a 14-year contract for up to £6.2 billion.** Through the 'Magnox contract', the NDA aimed to 'do the same for less' and give the contractor a stronger incentive to deliver savings for the taxpayer by replacing the existing cost-plus incentive fee contracts with a target cost incentive fee contract (TCIF). Under TCIF, the contractor's fee goes up if they are able to bring down the total costs of decommissioning, or down if the costs of decommissioning increase. HM Treasury approved the competition and contract award on the basis that the new contract would provide savings of at least 10% (paragraphs 1.3 to 1.6 and Figures 2, 3 and 4).

**2 In July 2016, the High Court found that the NDA had wrongly decided the outcome of the procurement process; the NDA agreed to settle claims in March 2017.** Energy Solutions, one of the incumbent contractors for the Magnox sites until 2014, unsuccessfully bid for the contract, and subsequently issued legal claims against the NDA for damages. The High Court found that, had the NDA applied its evaluation criteria correctly, the winning bidder, Cavendish Fluor Partnership (CFP), would have been excluded from the competition. It also found that, with respect to record-keeping, the NDA had breached its obligation under public contracting regulations to act in a transparent way. The NDA agreed settlements totalling £97.3 million (paragraphs 1.7 to 1.15, and Figures 6, 7 and 18).

Contract consolidation

**3 While defending the legal claims against its award of the Magnox contract, the NDA progressed a complex process of contract consolidation with CFP.** The NDA describes this contractual process as a "trueing-up" between what the contractor was told to expect and what it actually found on taking over responsibility for the sites. This phase was included in the contract because the NDA recognised that the state of the 12 sites – and therefore the nature, scope and cost of work – could be different to what was expected at the outset of the competition. Only by concluding this consolidation process could the NDA agree what fee to pay CFP and determine whether it could achieve the 10% savings target set by HM Treasury (paragraphs 2.1 and 2.2).

**4 During consolidation, the expected costs of decommissioning the Magnox sites increased from £3.8 billion in CFP's winning bid in 2014 to £6.0 billion in 2017.**

The NDA attributes £0.7 billion of this increase to a revised understanding of the volume of waste and asbestos on the sites, which the NDA says could not be quantified before work under the contract began. Of the remaining £1.5 billion of cost increases, £1.0 billion was forecast by the NDA at the time it awarded the contract, but £0.5 billion was not expected. The NDA does not know to what extent this unexpected additional cost reflects inaccurate assumptions about the state of the sites in 2012, when the contract baseline was established, or potential underperformance by the previous contractor between 2012 and 2014. The NDA's internal audit function reported in March 2017 that there was "a risk that the NDA may have paid for work which has been incorrectly reported as completed by the previous contractor". Since this interim internal audit report was published, the NDA has not undertaken any work to establish whether it may have paid for work that was not performed (paragraphs 2.7 to 2.10, 3.19 and Figure 9).

**5 The contract provided for the consolidation process to last 12 months and conclude by September 2015, but the process continued without resolution until March 2017.**

The NDA agreed to extend the contractual deadline to complete consolidation from September 2015 to March 2016 because of the volume and complexity of the changes required. In June 2016, NDA executives notified the NDA Board that they had reached an informal agreement with CFP to conclude consolidation, but that some details still had to be finalised. However, the NDA subsequently decided not to formalise this agreement after receiving legal advice, and after the High Court judgment in July 2016 caused the organisation to reduce its risk appetite. In December 2016, NDA Board minutes noted the risks associated with "reaching an agreement which is not in line with the mechanisms envisaged in the contract" (paragraphs 2.3 to 2.6, 2.11 and Figure 8).

## Contract termination

**6 From May 2016 onwards, the NDA received legal advice on the risk of legal challenge created by the changes proposed to the contract since it was awarded in 2014.**

The volume of changes proposed to the contract left the contract vulnerable to legal challenge, and the NDA's proposed approach to concluding consolidation in June 2016 would have made it more difficult to defend any legal challenge on the grounds of material variation to the contract (paragraphs 2.11 and 2.12).

**7 In March 2017, the Secretary of State announced the NDA's decision to terminate the contract with CFP nine years early.**

On 29 September 2017, the NDA, with approval from the Secretary of State, served a notice of termination to CFP effective from 1 September 2017, allowing for a 24 month notice period, ending 31 August 2019. The NDA is considering options for how the Magnox sites should be managed once the contract with CFP comes to an end. These include competing a new contract, or as with its Sellafield site, bringing the site licence company into the NDA's direct control (paragraphs 2.13 and 2.14).

## Governance and oversight

### **8 For the procurement, the NDA Board relied on internal audit, external assurance reviews and legal advice that did not detect the problems later identified in the High Court judgment.**

- Two internal audits and four external assurance reviews rated the procurement process as 'green' or 'amber green'. The reviews did not examine whether the evaluation of the bids adhered to public contracting regulations. The NDA did not commission further assurance reviews of the evaluation process or outcome of the competition after it became aware of Energy Solutions' legal claims.
- The NDA's Competition Programme Board, with representatives from HM Treasury, UK Government Investments (UKGI) and the Scottish Government, approved key documents, including the evaluation design and tender evaluation report, before they were approved by the NDA Board. The Department for Business, Energy & Industrial Strategy (the Department) and HM Treasury approved the decision to award the contract to CFP. The decision was also endorsed by the Scottish Government.
- The NDA requested and received two letters of comfort from its legal advisers, Burges Salmon. In the first, Burges Salmon noted that as of September 2013, the NDA had complied with its obligations under public contracting regulations. In the second, dated March 2014, Burges Salmon set out its involvement in the competition process, which included a review of all the NDA competition team's evaluation scores against evaluation comments to check they were consistent. Burges Salmon confirmed that, subject to the NDA evaluators reviewing and acting on their advice, they were "not aware of any reason" for the NDA not to appoint CFP (paragraphs 3.1 to 3.12 and Figures 10 to 12).

**9 For the consolidation process, certain formal governance arrangements were not in place until August 2015, a month before the contractual deadline to complete the process.** HM Treasury approved the contract award and share transfer to CFP in July 2014 subject to the NDA establishing an appropriate approval process for change controls through a Change Control Board (CCB) to supplement its existing change control review and approval processes. A review by the Major Projects Authority (MPA) in June 2014 also highlighted the need for the adequate governance of change controls. The CCB, tasked with overseeing the process, did not meet until eight months into what was meant to be a 12-month process. The CCB's terms of reference were agreed 11 months into the process. NDA executives also told us that responsibilities between the teams managing the consolidation phase overlapped, as did the responsibilities of NDA executives, which was unhelpful (paragraphs 3.13 to 3.16 and Figure 13).



**10 Three reviews commissioned by the NDA assurance director cited significant risks with the consolidation process from December 2015.**

The reviews were shared with the programme's senior responsible officer and the NDA's chief financial officer, but the NDA Board was only informed of findings from the third review. In March 2017 an NDA interim internal audit report highlighted weaknesses with the quality of communication between NDA executives and the NDA Board during consolidation (paragraphs 3.17 and 3.18 and Figure 14).

**11 The Department and UKGI were aware of delays to the consolidation process and that the cost of the contract was likely to increase, but raised no formal concerns to ministers until August 2016.** HM Treasury and UKGI told us that they were concerned about the delays in consolidation, but relied on the NDA's assurances that a resolution would be achieved. From October 2016, a cross-government group of senior officials, including the chief executive of the civil service and officials from HM Treasury, the Department, UKGI and Government Commercial Function, met seven times to discuss the issues the NDA faced with litigation and consolidation (paragraphs 3.20 to 3.24).

#### Costs to the taxpayer

**12 We estimate that the Magnox contract cost the taxpayer upwards of £122 million.** The NDA agreed to settle legal claims with Energy Solutions and Bechtel at a cost of £97.3 million. It also spent £13.8 million on legal and external advisers. Of this, £3.2 million was spent on the competition and £8.6 million was spent on legal fees in the ensuing litigation. The NDA estimates that in-house staff time has cost £10.8 million. This excludes the cost of staff time of senior central government officials who were heavily involved in decisions, particularly about the NDA's settlement and its decision to terminate the contract. It also excludes the costs of the government's independent inquiry (paragraphs 4.1 to 4.5 and Figures 15 to 18).

**13 Before terminating the contract, the NDA forecast 13% cost savings (£904 million).** The NDA believes that, so far, CFP has reduced costs by around £255 million relative to the old contracts. We have not audited these figures. The NDA expects further savings to be made, but cannot yet verify the level of cost savings that could potentially be achieved by September 2019 (paragraphs 4.6 and 4.7).

## **Concluding remarks**

**14** Competitive procurement to appoint commercial partners to manage nuclear sites is central to the NDA's strategy. The NDA's fundamental failures in the Magnox contract procurement raise serious questions about its understanding of procurement regulations; its ability to manage large, complex procurements; and why, despite a number of internal and external assurance reviews, audits, and legal advice, the errors detected by the High Court judgment were not identified earlier.

**15** In addition to the failed procurement, the NDA faced serious problems after it awarded the contract to CFP. It is clear that the NDA had a poor understanding of what was happening on its estate: six sites were behind schedule at the time the NDA let the contract, and the NDA's assumptions about the work needed on the sites have proven to be inaccurate. The NDA's commercial strategy of using a target-cost contract, predicated on having a good understanding of the scope of work, now appears wholly inappropriate. It is time for the NDA to re-evaluate its commercial strategy and its capability to execute it, supported by expertise in government.

**16** As the NDA's sponsoring body, the Department must make an informed judgement about the extent and structure of the oversight it maintains over the NDA. The extensive challenges the NDA faced – from procurement through to the early termination of the Magnox contract – raise urgent questions about the Department's oversight of one of the largest contracts ever let by government. For example, the Department knew the proposed changes to the contract would have significant cost implications, but it did not make itself sufficiently aware of the scale of those costs for nearly two years. In light of these issues, the Department must consider whether its governance and oversight arrangements surrounding the NDA are sufficiently clear and effective in providing the scrutiny and assurance it requires to meet the standards expected in managing public money.