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Application of the Public Contracts Regulations to development agreements following *R (Faraday Development Ltd) v West Berkshire Council* [2018] EWCA Civ 2532

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Overview of procurement law

- Directive 2014/24/EU ("Public Contracts Directive"), implemented by Public Contracts Regulations 2015
- Associated EU and domestic legislation for procurement of utilities, concessions and defence & security.
- Procedural requirements (eg. OJEU advertising) whenever a "contracting authority" seeks offers in relation to a proposed contract for "works", "supply" or "service contract" where the contract is above a specificed threshold.
- Aim = *"to ensure that public bodies award certain contracts above a minimum value only after fair competition, and that the award is made to the person offering the lowest price or making the most economically advantageous offer":* per Lord Hope in ***Risk Management Partners v. Brent LBC*** (2011)
  - The Directive will be construed purposively in pursance of that aim

Definition of public contracts

- Art 2(1)(a): "'Public contracts' are contracts for pecuniary interest concluded in writing between one or more economic operators and one or more contracting authorities and having as their object the execution of works, the supply of products or the provision of services within the meaning of this Directive."

- The definition of "contracting authority" plainly includes local government

- "Economic operators" can include public bodies if they participate in the economic market: see ***Auroux v. Roanne*** & ***Teckal***

Public works contracts - meaning

- Defined by Art 2(6) as a *"public contract having as their object one of the following:*

  (a) the execution, or both the design and execution of works related to one of the activities within the meaning of Annex II;

  (b) the execution, or both the design and execution, of a work

  (c) the realisation, by whatever means, of a work corresponding to the requirements specified by the contracting authority exercising a decisive influence on the type or design of the work."

A 'work' is defined in Art 2(7) as *"the outcome of building or civil engineering works taken as a whole which is sufficient of itself to fulfil an economic or technical function."*

- Financial threshold (regularly updated) currently c.£4.5m

Contracts for the acquisition or rental of land are excluded under Art 10(a) - but not if the main object of the contract is works and the transfer is ancillary to that.

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Principles from the previous case law (1)

- The main purpose of the agreement will determine whether or not it is a contract for public works: ***Auroux***, ***Gestion Hotelera***, ***Commission v. Spain***
- Where the agreement involves works which are not the main object of the contract but are incidental to another object which is outside the scope of the Directive, the Directive does not apply: ***Gestion Hotelera***
- To be a *"work"* a development must be sufficient to fulfil an economic or technical function for the contracting authority's immediate benefit, and something more than simply achieving a beneficial development in the public interest is required:

Principles from the pre-2016 case law (2)

  - the contracting authority needs to derive an actual economic benefit from the scheme as it did in ***Auroux*** (financial contribution, assumption of risk)
  - not necessary that the contracting authority must be/remain the owner of all or part of the land on which the works take place (<u>but</u> if it is, then this criterion is satisfied)
- To fall within the scope of the Directive, the contract needs to place the contractor under a "direct or indirect**" legally enforceable contractual obligation** to carry out the works in question (***Helmut Muller; Flensburg***; ***Midlands Co-Op***)

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Principles from the pre-2016 case law (3)

- *"The requirements specified by the contracting authority"* criterion is not met by the mere fact that a development must comply with the local authority's planning policies and objectives
  - *"The authority must have taken measures to define the type of the work or, at the very least, have had a decisive influence on its design"* (***Helmut Müller*** para. 67).
  - Precisely where the dividing line lies in practice remains unclear. The level of specification does not appear to have to be rigorous. In ***Auroux***, it was sufficient that "*the work referred to by the agreement is the leisure centre as a whole, including the construction of a multiplex cinema, service premises for leisure activities, a car park and, possibly, a hotel.*" (para. 42).

Midlands Co-Op: application of the principles in the s.106 context

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- ***Helmut Müller*** applied in ***Midlands Co-Op*** [2012] LGR 39 where a planning agreement between Tesco and Birmingham CC held not to be procurable. Hickinbottom J at [110]:
  - "At all material times, the "replacement community facilities" formed part of Tesco's planning permission and … the section 106 agreement obliged Tesco to be responsible for all works of fitting out and re-location costs of "the Replacement Community Facilities" … there is force in Mr Holgate's submission that, if and when the section 106 agreement in its current form is triggered, then there would be an obligation on Tesco to perform works, legally enforceable by the Council. The matter would legally, then, be out of Tesco's hands. However, Tesco was not … (and, indeed, is not today) committed to any of the obligations ... Those obligations do not arise unless the planning permission is implemented (i.e. the development is started). That start is conditional on a variety of matters and, in any event, Tesco is not legally committed to start the development at all."

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Midlands Co-Op v Birmingham CC (cont'd)

- Hickinbottom J. recognised the freedom of a local authority to choose whether to impose an obligation to provide works or to merely use its regulatory powers [116] –
  - "The advantage, from the Council's point of view, was that the onerous provisions of the procurement provisions would not apply to the sale of the land, and may not apply to any part of the arrangement. The disadvantage is that they lost the imposition of an obligation on the successful bidder to commit themselves to the development obligations. However, these are the different sides of the same coin: both derive from the presence or absence of contractual obligations to perform works."

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Anti-avoidance: the background

- Recital 5 to the Directive: : *"… nothing in this Directive obliges Member States to contract out or externalise the provision of services that they wish to provide themselves or to organise by means other than public contracts within the meaning of this Directive"*
- Article 18(1): *"The design of the procurement shall not be made with the intention of excluding it from the scope of this Directive or of artificially narrowing competition."*
- ***Commission v Austria*** C-29/04 [2005] ECR I-9705 ***(***aka ***Mödling)*** to avoid procurement, award of a waste contract with a company wholly owned by the municipality at the time of the contract with a transfer of 49% of shares into private ownership shortly afterwards -
  - [40] "*an artificial construction comprising several distinct stages*"
  - [41] that the award of that contract must be examined "*taking into account all those stages as well as their purpose and not on the basis of their strictly chronological order*"

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The Faraday Case

R (Faraday) v West Berkshire: facts

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- WBC wished to secure "*the comprehensive development … for the purposes of regeneration and maximising income*" of a 10 ha industrial estate in Newbury
- Development agreement (DA) awarded following a lengthy public process from 2011-14, ending in tenders, which made it clear was intended to fall outside the procurement regime
- Complex DA which imposed obligations on development St Modwen to undertake various preliminary design and planning services (held not to be relevant) but no obligation to undertake works until a procedure had been followed with regard to design, planning and viability assessment and, even then, the developer had an option not an obligation. The obligation to undertake works specified by WBC only arose if it drew down the land under the DA.
- Details of the DA are set out in Annex to the CA judgment

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R (Faraday) v West Berkshire: High Court

- Holgate J rejected a best consideration challenge under the Local Government Act 1972 and also held that the DA was not a PWC within the 2006 Regulations because the developer decided whether or not to trigger the works obligations
- He held it was not a public services contract since the services were subordinate to the main purpose of the DA which was the securing of works to regenerate the site
- He rejected any suggestions that an abuse of rights or anti-avoidance policy should apply to the DA
- The VEAT notice issue was not pursued by the Defendant Council at the hearing in the High Court

R (Faraday) v West Berkshire: Court of Appeal (1)

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- [2018] EWCA Civ 2532 14.11.18. Allowed the appeal, held the VEAT notice invalid, made a DoI and imposed a nominal civil penalty. Critical to Lindblom LJ's conclusions were the following:
  - It was necessary to look at the substance of the contractual arrangements [60]
  - although it was not sufficient to make the agreement a PWC that only WBC had committed itself contractually, and the developer could walk away, nonetheless "*once it has drawn down the land, will be bound to develop it in accordance with the development agreement*" [50]
  - WBC had done all that it could and *"committed itself to procuring the development from St Modwen. The development agreement constitutes a procurement in its result, and a procurement without a lawful procurement procedure... The procurement crystallizes when St Modwen draws down the land*." [61]

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R (Faraday) v West Berkshire: Court of Appeal (2)

- Not yet a PWC:
  - [51] *"… because St Modwen's obligations to carry out works under the development agreement, though plainly directed to the object of that contract, are – for the moment – contingent obligations, the development agreement is not yet a "public works contract". This conclusion, in my view, is not inconsistent with the authorities, European or domestic*."
- But, that was not the end of the matter if the Council had under the DA committed itself to grant a future PWC without procurement:
  - [59] "*The court must consider the relevant transaction in its totality to establish whether the contracting authority has, by its "decision or action", procured, or contractually committed itself to procuring, works or services from a particular economic operator*."

R (Faraday) v West Berkshire: Court of Appeal (3)

- "*If the development agreement was not a "public works contract" on the day it was entered into, because St Modwen was not then under an immediately enforceable obligation to carry out development, it will nevertheless become a "public works contract" once the option is exercised, the land is drawn down, and binding obligations, for consideration, are triggered*." [57].
- "*it was only at that stage, at the time when the development agreement was being entered into, that the council had to consider whether it was under a duty to conduct a regulated procurement – because otherwise a timely procurement procedure, or any procurement procedure, was going to be impossible. The touchstone, then, is whether, in substance, the agreement in question, at the date it is concluded, provides for a relevant procurement*." [60]

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R (Faraday) v West Berkshire: Court of Appeal (4)

- "*By entering into the development agreement, therefore, the council effectively agreed to act unlawfully in the future. In effect, it committed itself to acting in breach of the legislative regime for procurement*." [62]
- "T*he only other possibility would be that a contracting authority is at liberty to construct a sequence of arrangements in a transaction such as this, whose combined effect is to constitute a "public works contract", without ever having to follow a public procurement procedure. That would defeat the operation of the legislative regime*." [62]
- The authorities required the court "*to look at the real substance of the transaction, and to view the several stages of a "multi-stage" process as a whole. In this case that entails not only a first stage, comprised in the development agreement itself, but also a second stage provided for in it, which is initiated when the option is exercised and land is drawn down by the developer…*" [63]

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R (Faraday) v West Berkshire: Court of Appeal (5)

- *"In that second stage the developer's obligation to execute the works is effective, and the public works performed. Inherent in this two-stage process is a public procurement. The breach of the 2004 Directive and the 2006 regulations occurs when the land is drawn down by St Modwen. At that point the council retains its contractual control over the content of the works, but has no further control over the award of the contract for their execution. Once the option is exercised, the council is obliged to enter into a long lease, and St Modwen is obliged, under both the lease and the development agreement, to bring the works to fruition.*" [63]
- Accepted that a contingent obligation did allow the developer to "walk away" without assuming works obligations to the extent that it chose not to exercise the entitlement to draw down land [48].
- In that respect similar to ***Midlands Co-Op***? Tesco there could choose not to implement the permission and trigger the obligation.

R (Faraday) v West Berkshire: Court of Appeal (6)

- The CA distinguished ***Midlands Co-Op*** on the basis that it concerned as s.106 planning agreement:
  - "53. The section 106 planning obligation was also a very different kind of agreement. It had a distinct status and role in the statutory planning scheme. Its purpose was to regulate the development of land for which the local planning authority was granting planning permission. By its terms the developer, and its successors in title, would not be able lawfully to proceed with the development for which planning permission was granted, and in particular would not be able to demolish the existing community facilities on the development site, until it had constructed replacement facilities. The section 106 agreement did not oblige the developer to proceed with the development. But in any case it was not the kind of transaction that is governed by the public procurement regime. By its very nature, it was not a "public works contract". …"
- Are s. 106 agreements now wholly outside of the procurement regime? A point left open by the express terms of the judgment in ***Midlands Co-Op***.

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R (Faraday) v West Berkshire: Court of Appeal (7)

- CA rejected the contention that WBC's approach should be struck down as a deliberate abuse of rights or on grounds analogous to the UK tax avoidance cases at [68] and [70] – not a ***Mödling*** case - "*no suggestion, of the council having acted at any stage in bad faith, or with any motive to create a mistaken understanding of its objectives in entering into the development agreement*"
- At [69] some recognition of freedom of contract –
  - *"It was not unlawful for the council to put in place a contractual relationship with a developer… to secure the regeneration of the industrial estate. Nor was it inherently unlawful for the council to seek to achieve, if it could, a lawful contractual relationship … that fell outside the reach of the public procurement regime. It was lawfully entitled to attempt to find such an arrangement..."*
- The judgment did not expressly grapple with Recital 5 or Article 18 of the Directive

Where are we now? (1)

Arrangements that are clearly caught by the PCR

- Agreements imposing obligations for works (above the relevant £threshold) whether those obligations are unconditional or contingent upon some action/condition which would generate an enforceable obligation to perform the works without procurement at that stage.

Arrangements that appear to remain safely outside the PCR

- Arrangements below the relevant thresholds (currently c.£4.5m for works)
- Straight no strings attached and sale but with no obligation (either conditional or unconditional) rather an incentive / understanding – but beware Article 18 and ***Modling***

Where are we now? (2)

Other

- Grampian style provisions (where breached, there remains no obligation to do works but rather the action that should not have bene commenced before the works is unlawful)
- Step-in rights (***Flensburg***)
- Section 106 obligations: difference between CIL Reg 122 compliant obligations (necessary to make the development acceptable and thus planning regulation) and 'voluntary' obligations that go beyond what is strictly necessary (arguably not planning regulation?
- DA concluded in the past without procurement the original entry into which is safe from challenge but which now requires modification (***Pressetext***, Reg 72, ***Gottlieb*****).**

NB the risk of challenge in practice is reduced due to (1) ***Wylde*** reducing the scope for JR by non economic operators and (2) the possibility for a valid VEAT notice to flush out PCR challenges by economic operators.