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Application of Public Contract Regulations to Development Agreements following *R (Faraday Development Ltd) v West Berkshire Council* [2018] EWCA Civ 2532

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March 2019

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Directive 2014/24/EU, recital (5)

"… 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"

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Approach to PWCs in the land use context

- ***Auroux*** C-220/05 [2007] ECR I-385 – relatively broad approach to application of the directive and PWC
- Subsequent narrowing of that broad approach?
  - ***Helmut Müller*** C-451/08 [2011] P.T.S.R. 200 required a legally enforceable contract, binding under national law, to provide specified works – regulatory requirements insufficient
  - ***Commission v Spain (Re award of urban development contracts in Valencia region)*** C-306/08 [2011] 3 C.M.L.R. 43 - AG Jääskinen [70]-[75] suggested a more restrained approach to land use agreements
- ***City of Flensburg*** (IP/08/867) Commission satisfied not PWC since land transaction which only required the land to be repurchased by the City if the works to provide a building were not undertaken. Measures to encourage performance falling short of contractual obligation insufficient.

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CJEU and the Commission

- ***Helmut Müller GmbH*** at [63] – to be a PWC the relevant agreement must impose a legally enforceable obligation on an economic operator to undertake works. An agreement that does not impose such an enforceable legal obligation is not a PWC and is not subject to procurement – the exercise of planning regulatory powers to require works is not sufficient so a local authority that merely requires works by imposing requirements in a planning permission is not caught
- AG Mengozzi at [78]
  - "a public works contract is to all intents and purposes a contract, that is to say, a legal document which, in all the variety of national legal systems, is by nature binding at all times and in all circumstances. … in order for there to be a public works contract, the contractor must be under a contractual obligation to provide the specified service. However, the consequences of any failure to fulfil obligations are a matter of national law…."

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CJEU and the Commission

- ***Commission v Spain (Valencia)*** C-306/08 AG Jääskinen [70]-[75]
  - "73. In considering what fits the public procurement frame the Court's case law to date has adopted a relatively broad, public procurement-friendly approach. This has given rise to a debate as to whether land-use agreements are or should be classified as public contracts or more precisely as public works contracts as they often involve, directly or indirectly, the execution of public works by the developer or the landowners…"
  - "75. … in my opinion the Court should exercise a certain restraint if a broad interpretation of an EU law concept seems to lead, in practice, to an instrument of national law losing its raison d'être or a detailed EU legislative act becoming applicable to phenomena that have not been considered by the EU legislature during the legislative process."
- ***City of Flensburg*** (IP/08/867)

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Anti-avoidance

- ***Commission v Austria*** C-29/04 [2005] ECR I-9705 ***(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"
- ***Remondis GmbH v Region Hannover*** C-51/15 (21.12.16) transfer of waste tasks to a public law entity created by agreement by 2 authorities to which powers for the performance of those tasks were transferred not a public contract provided it was autonomous.
  - **CJEU** [43] "The synallagmatic nature of the contract is thus an essential element of a public contract.."
  - **AG Mengozzi** at [36] "an essential element … is the creation of legally binding reciprocal obligations"

Midlands Co-Op v Birmingham CC

- ***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" ….. 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

- 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."

Midlands Co-Op v Birmingham CC

- Distinguished in ***Faraday*** –
  - "39. … This case was also quite unlike ***Midlands Co-operative*** *Society*. The development agreement was a very different sort of arrangement from the sale and purchase agreement between developer and local authority in that case, and the section 106 planning obligation. The court must ask itself whether this was a transaction in which the council entrusted the execution of public works to a developer. It was. The whole purpose of the development agreement was that St Modwen would carry out the works…"
  - But in ***Helmut Müller*** there was no agreement– and the planning obligation in ***Midlands Co-Op*** was an agreement that otherwise fulfilled PWC requirements. St Modwen did not bind itself to undertake the works.

Midlands Co-Op v Birmingham CC

- Also distinguished in ***Faraday*** as a 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 wholly outside of the procurement regime? Not the basis of ***Midlands Co-Op*** and not argued in ***Faraday***
- A significant extension to ***Helmut Müller*** ?

AG Quidnet Hounslow LLP

- ***AG Quidnet Hounslow LLP v Hounslow LBC*** [2013] P.T.S.R. 828. Coulson J. was concerned with a development agreement that was deliberately structured so as not to impose an enforceable legal obligation to carry out works. The claimant recognised, as a consequence of ***Müller***, this meant the Directive did not apply, but nonetheless sought to contend that the agreement was subject to an equivalent requirement to conduct some form of transparent award procedure pursuant to EU General Treaty principles. This was rejected underlining the parties' freedom to choose:
  - "42 … There is no express obligation on the part of L&G to develop the site or provide any services whatsoever. Whilst … this was the deliberate result of careful drafting, so as to avoid the consequences of the 2006 Regulations, the fact remains that the heads of terms require no services to be provided by L&G. If L&G subsequently find themselves faced with the commercial necessity of developing the site …then that is a matter for them."

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 only imposed obligation on developer St Modwen to undertake preliminary 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 only an option to buy. The obligation to undertake works specified by WBC only arose land drawn down under the DA.
- Details of the DA are set out in Annex to the CA judgment

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Faraday: 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
- 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 in the High Court (though it was before the Court)

Faraday: Court of Appeal

- [2018] EWCA Civ 2532 14.11.18. Allowed the appeal, held the VEAT notice invalid, made a DoI and imposed a token 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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Faraday: Court of Appeal

- Ground 1 rejected -
  - [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." **Not a PWC at the date it was entered into**.
- Ground 2 -
  - [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." **Extended meaning of PWC to include future actions provided for in the contract**.

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Faraday: Court of Appeal

- "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]

Faraday: Court of Appeal

- "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]
- "The 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]

Faraday: Court of Appeal

- "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

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Faraday: Court of Appeal

- 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, without at any stage intending the arrangement to be unlawful."

Faraday: VEAT notice & remedies

- The CA also rejected the VEAT notice (VTN) as not complying with Case C-19/13 ***Ministero dell'Interno v Fastweb SpA*** [2015] P.T.S.R. 111 focusing on the strictness of the requirements [80] since the notice incorrectly or misleadingly -
  - described the DA as an "exempt land transaction" [89] which "was more than mere over-simplification" [89]
  - referred to there being "…"no binding obligation" on St Modwen, even if read as meaning "no immediately enforceable binding obligation", still leaves too much unclear" [90]
- Also the description did not "alert a third party to the real nature of the transaction."
- Declaration of Ineffectiveness made
- Civil penalty required to be imposed but only imposed £1

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Where does the Court of Appeal's judgment in ***Faraday*** leave the freedom "to organise by means other than public contracts within the meaning of this Directive"?

Where does that leave us?

- Recital (5) begs the question of whether the agreement falls within the autonomous meaning of a PWC and in that respect what was meant in ***Müller*** "is by nature binding at all times and in all circumstances" [AG 78] and ***Remondis*** "an essential element of that concept is the creation of legally binding reciprocal obligations" [AG 36].
- CA in ***Faraday*** did not reject the proposition that it was open to a public authority to choose whether or not to enter into a PWC (see the rejection of Ground 1). The choice must be examined to see if the agreement properly fell outside the PWC regime – not the case in ***Faraday***
- On this basis, even though an economic party only binds itself to provide the public works specified by the authority if it choses to do so at a future date, and following the satisfaction of certain conditions, this is sufficient to bring it within the PWC regime

Where are we now?

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- Where does the distinction between ***Midland Co-Op*** and the DA option in ***Faraday*** lie?
- Does it turn on the fact one was a planning obligation though ***Helmut Müller*** was decided on the basis of no agreement requiring works but merely the use of regulatory powers?
- Does it matter that the option process is formally set down in a DA as opposed to being a simply condition precedent controlled by the economic operator?
- Do planning obligations fall outside the PC regime?
- Will any agreement otherwise fulfilling PC requirements be sufficient if in some form it recognises the developer may at some stage undertake works or is the line drawn if there is a mechanism to allow the developer to choose to undertake the works?
- What about ***Flensberg*** where provisions intended to provide a strong incentive were found not to fall within the PWC regime?
- The ability to arrange matters outside the PC regime clearly requires considerable caution.