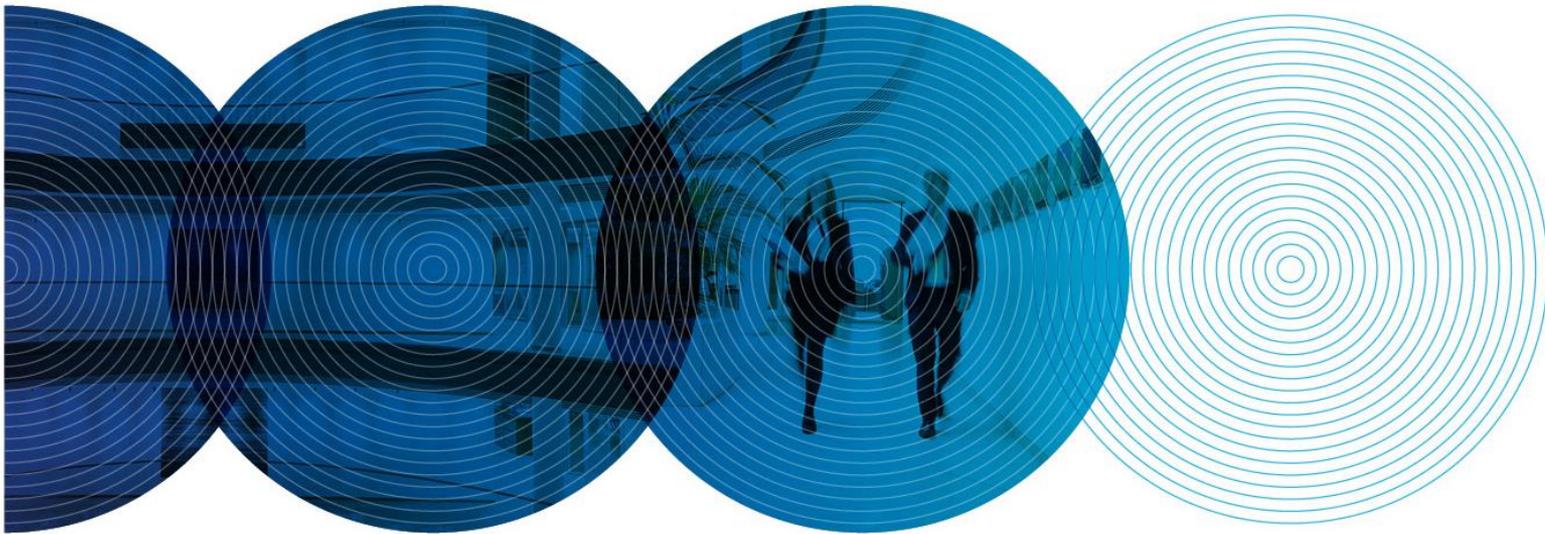

Variations

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The topic

What practical steps can you take to de-risk contracts or frameworks that reach or exceed their thresholds, and you are faced with an unwanted variation?

Overview – topics covered

- Why are we concerned about rising contract values and variations?
 - *The law on material change*
 - *Exceeding the estimated value of a contract*
- De-risking variations
 - *Future proofing*
 - *Managing tender processes*
 - *Governance*
 - *Contract management*

Background – why the focus on variations?

- C-454/06 *Pressetext*
 - *Article 72 of Directive 2014/24*
 - *Article 89 of Directive 2014/25*
 - *Safe Harbours*
- Recent case law on estimated contract value
 - *Autorita Garante*
 - *Simonsen & Weel*
 - *Epic Financial Consulting*

Material change

- Key principle of European public procurement law: material changes must not be made (a) during competition or (b) over life of contract
- Originated in case law (*presetext* C-454/06) and now codified and expanded upon in the Regulations.
- Material change is treated as the unlawful direct award of a new contract
- A change is **prohibited** unless it falls within one of the safe harbours in Article 72/Regulation 72
- Material change rules apply even if the changes to the contract are required to settle litigation/dispute – *Finn Frogne* (C-549/14)
- Quite often the issue arises when an extension is required to ensure continuity of service during a procurement challenge

Safe Harbours (1)

- Change permitted, regardless of monetary value, where provided for in procurement documents in “clear, precise and unequivocal” review clause (e.g. price revision or options clauses)
- Provisions must state the nature & scope of possible change and conditions under which they may be used
- Cannot alter overall nature of the contract
- Not clear what level of detail in clause is required
 - *Lots of English cases confirming that a broad power to vary is not sufficient*
 - *Edenred UK case*
- No need to publish a modification notice

Safe Harbours (2)

- Additional works/services/supplies by original contractor become necessary, where a change of contractor:
 - *cannot be made for economic or technical reasons eg requirements for interchangeability and interoperability and*
 - *would cause significant inconvenience or substantial duplication of costs*
- Cannot exceed 50% of the value of the original contract (except under Utilities Directive)
- Must publish notice of change in OJEU

Safe Harbours (3)

- Change needed due to circumstances which a diligent contracting authority could not have foreseen
 - *Covid-19*
 - *See Eircom UK Ltd v Department of Finance [2018] NIQB 75*
- Cannot modify the overall nature of the contract
- Cannot exceed 50% of the value of the original contract (except under Utilities Directive)
- Must publish notice of change in OJEU

Safe Harbours (4)

- New contractor replaces original contractor due to
 - *“unequivocal review clause” as with first safe harbour, or*
 - *another entity succeeds first entity due to corporate restructuring eg insolvency/takeover/merger etc*
 - new entity must meet original pre-qual criteria
 - no other substantial modifications to contract
- *No need to publish modification notice*

Safe Harbours (5)

- Change below EU threshold value and <10% initial value for service/supply contracts/ <15% for works contract
- No modification to the overall nature of the contract
- Successive modifications must be assessed on net cumulative value
- No need to publish a modification notice

Safe Harbours (6)

- Change permitted, irrespective of value, if it is not “substantial”
- “substantial” – change renders contract “materially different” from original contract, which is presumed if the change:
 - *could have attracted different participants to the competition or led to a different outcome of either the PQQ or tender stage*
 - *changes the economic balance of the contract*
 - *considerably extends the scope of the contract*
 - *Amounts to a change of contractor outside the circumstances set out in safe harbour (4) above*
- No need to publish modification notice in the OJEU

Case study – James Waste v Essex CoCo (1)

- Waste disposal contract modified to direct the operator to transfer waste to a new disposal site not originally provided for, with modifications to fee
- Challenged by incinerator owner whose waste disposal facility suffered from the change
- Change worth approx. €775k in the context of an 8 year contract worth over €100m
- Court determined:
 - *Safe harbours must be construed narrowly*
 - *However burden of proof lies with challenger to show that modification is not justified*
 - *Safe harbours not cumulative – no need for changes justified by other safe harbours to be below EU threshold for de minimis safe harbours*
 - *Common sense approach*

James Waste v Essex CoCo (2)

- Contract clause safe harbour not available as the process not followed
- “Not substantial” safe harbour
 - *Court not convinced other tenderers would have bid/won if they had known of the change*
 - *Changing the economic balance of the contract – doesn’t mean things have to stay static. Where things change, ensure the balance is maintained – reasonable and commercial payment*
 - *€775k in a €100m contract not “considerable”*

Exceeding the advertised value of a contract

- Traditionally it was understood that the advertised estimate in the Contract Notice was just an estimate, with the purpose of:
 - *Ensuring that contracts above the threshold are advertised*
 - *Gives the market a sense of the scale of the opportunity*
- Not previously understood as a hard limit – it wasn't necessarily a “modification” to the contract if the value ended up being higher provided that the scope was as advertised
- Recent case law introduces complications with regard to framework agreements in particular

Framework agreements case law

- Autoritá Garante C-216/17
 - *Estimated advertised value of contract is a cap*
 - *Authorities must also use best endeavours to disclose the value and frequency of the call-off contracts*
- Simonsen & Weel C-23/20
 - *Contract Notice stated that they could not give exact value as it would depend on demand, and explicitly noted that the actual value might be higher or lower than any estimate they could provide*
 - *ECJ held that once advertised value is met, framework agreement will cease to have effect and should no longer be used*
 - *ECJ said that contract notice should include estimated value and maximum value*
 - *Luckily, confirmed Art 72 safe harbours still available*
- EPIC Financial Consulting (Joined Cases C-274/21 , C-275/21).
 - *Confirmed strict approach even in a directly awarded framework agreement*

In practice

- Case law seems to envisage authorities having a crystal ball
- But what about:
 - *Inflation?*
 - *Unexpected disruption to supply chain?*
 - *Increased costs e.g. arising from Covid-19?*
 - *Additional need for works/services/supplies arising because of changed circumstances?*
 - *The public good associated with continuity of service where possible?*
 - *Technological change?*
 - *Scope creep?*

De-risking the design of the opportunity

- Consider what you want from the contract
 - *What additional scope/options might be required/beneficial?*
 - *Extension options?*
 - *Who is bearing price risk of change/inflation?*
 - Is your priority price stability or continuity?
- Plan the terms of the opportunity from the outset
 - *Build in flexibility into procurement documents and contract*
 - *Indexation*
 - Standard or sensitive/tailored?
 - *Scope flexibility*
 - Options, technological change, increased volumes/frequencies
 - *Pricing mechanisms for planned or potential change*

De-risking advertisement

- Estimated value in OJEU notice
 - *Estimated value – realistic with some float*
 - *Maximum value – cap*
 - *New eForms from 25 October 2023*
- Language in OJEU notice emphasising variable nature of need and consequential variance in contract sum
 - *Simonsen & Weel shows this language does not disapply general rule that estimated value is a cap*
 - *But helps in an argument that the Art 72 safe harbours apply*
- Be cautious in how you describe the winning price in a contract award notice
 - *Use additional information field to explain if that price is discounted or nominal only*

De-risking the tender period

- Risk – that the successful tenderer won't commit to terms/standards that tender documents insist on
- It is risky to drop material items in negotiation with preferred tenderer
 - *Don't gold plate requirements*
 - *Don't insist on terms that you would live without*
 - *Include contract mark up phase as part of tender process*
- Inflation during tender period?
 - *Traditional approach*
 - *GCCC response to unprecedented construction inflation*
 - *Tender refresh?*

De-risking governance

- Internal audit, C&AG, PAC etc
- Ensure internal business case and approval documents are clear about
 - *Variable nature of pricing depending on usage (where applicable)*
 - *Additional costs for pre-planned options*
 - *Estimated cost plus estimated maximum cost*
 - *Any discounts or notional sums applied to the evaluation price*

De-risking contract management

- Visibility is key
 - *Manage scope creep*
 - *Ensure variations are carefully considered from a legal/procurement perspective*
 - *Ensure contract managers are aware of limitations on variations*
 - *Ensure you track spend v advertised budget*
 - *Early warning systems where you are nearing limit*
- Key issue – what does the contract say?
- Changes to concluded contracts generally not permitted – unless the Reg 72 safe harbours apply

Takeaways

- Procurement planning
 - *Consider scope and price risk allocation and ensure position is clear and thought-out*
 - *Consider duration of contract*
 - *Consider tailored indexation*
 - *Specify any potential options/extensions*
 - *Include a clear, precise and detailed variation mechanisms*
- Tender period
 - *Contract mark-up to allow for issues to be flushed out*
 - *Keep tender periods as short as possible so that inflation does not become a significant issue*
 - *Consider tender price refresh in lengthy tender processes if the market cannot hold price*
- Contract period:
 - *Use the powers you have under contract*
 - *Monitor spend*
 - *Pay particular attention to framework agreements*

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