Faraday and after: development agreements, ineffectiveness and the mitigation of risk

Nigel Giffin QC

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The question posed, and a short answer

"How has the Faraday judgment moved the law and market practice concerning (1) VEAT notices and (2) the drafting of development agreements? Where are clients open to challenge?"

(*R (Faraday Development Ltd) v West Berkshire Council* [2019] PTSR 1346

In my view –

- Limited impact so far on approach to DAs (both *Faraday* and *Ocean Outdoor UK Ltd v Hammersmith & Fulham LBC* [2019] PTSR 1714 take quite a conventional approach – facts of *Faraday* represent extreme case of attempted avoidance)
- But enhanced awareness of ineffectiveness risk, and much greater attention paid to drafting of VEAT notices

Faraday summarised

- Competition held for contract aimed at redevelopment of site owned by local authority
- Treated as not governed by PCR – no OJEU notice, no published and defined evaluation criteria
- Authority did publish a VEAT notice
- Challenged by member of losing consortium (brought both a PCR claim, and a JR claim), for non-compliance both with PCR and with s 123 of Local Government Act 1972 (best consideration duty)
- Claim failed at first instance – appeal (on PCR only) succeeded in Court of Appeal – contract declared ineffective on footing that VEAT notice invalid

The structure of the DA in *Faraday*

- Developer (St Modwen) was under no obligation to carry out any works, unless and until it served notice to take a lease of a particular plot after the DA conditions (planning consent etc) were satisfied
- If notice was served, both DA and lease did oblige StM to develop the plot in accordance with masterplan etc
- StM was obliged from outset to perform certain services by way of developing design for WB's approval, preparing planning application etc – these services were themselves of above threshold value, but much less valuable than proposed works, and were useful only as a means to the end represented by those works

Why the DA in *Faraday* was held ineffective by the Court of Appeal

- DA as signed was not itself a works contract, because it contained no enforceable obligation to carry out works – drawdown was genuinely at StM's option, and this was not a sham (even though whole transaction assumed that parties would want this to happen)
- If option was exercised, a works contract would come into being – once DA signed, this was outside WBC's control – but that works contract would not have followed a PCR-compliant process, so entering it would be unlawful
- Therefore it was unlawful for WBC to take a step (signing of DA) which committed it, at option solely of StM, to a future unlawful act – could be viewed either as public law illegality or as anticipatory breach of PCR
- VEAT notice failed to provide sufficient, accurate information – referred to contract merely as an exempt land transaction, when in fact it contained "intricate provisions for the design and execution of a large development"

Arguments rejected by CA in *Faraday*

- That DA was a works contract because it was a written contract for consideration whose object was in substance the carrying out of works – CA ultimately stuck with relatively literal reading of *Helmut Müller*
- That it should be treated as an unlawful "abuse of rights" by WBC to avoid procurement obligations (NB contract was awarded under PCR 2006, so claimant could not rely directly on PCR 2015 r.18(2)) – Lewison LJ in minority in preferring to leave open
- That if DA was not a works contract, it was a services contract because of enforceable services obligations – CA held that main object of contract was the works, despite absence of an obligation to do them

The further decision in *Ocean Outdoor*

- Both O'Farrell J and CA rejected claim that grant of lease of sites including advertising screens was a service concession which should have been put out to procurement
- Reasons were that:
  - LBHF did not entrust a public service to lessee
  - No direct and enforceable obligation on lessee to provide an advertising service from the sites, and any advertising was not for the direct economic benefit of LBHF
  - Leases fell within scope of "land exemption"

Development agreements: where are we now?

Main questions in deciding whether a procurement is required:

1) Is this a contract containing an obligation to carry out works (or can it become so without a further decision by the authority)?

2) If so, are works for the authority's direct economic benefit? (Query also – does the authority sufficiently control the design?)

3) If so, are those works the main object of the contract (in particular, as opposed to a land transaction)?

4) If so, is the contract value above the threshold?

5) If so, does any express PCR or CCR exemption apply?

6) If not caught by PCR/CCR, are there other EU/domestic law obligations which call for a competition (Article 56 TFEU; state aid; LGA72 s 123/TCPA90 s 233; general public law principles)

Works obligations (1)

- What sort of conditionality might take a DA outside *Faraday*?
  - ➢ Conditions outside control of either party?
  - ➢ Residual authority discretion (at what point might exercise of it be unlawful?)
- "No obligations" drafting techniques
  - ➢ Reversion and termination clauses
  - ➢ Negative covenants restricting use
  - ➢ Financial (dis)incentives

Works obligations (2)

- Potential limits to “no obligations approach”
  - Obligations in substance?
  - Reg 18(2)(“The design of the procurement shall not be made with the intention of excluding it from the scope of this Part …”)
- Potential hazards:
  - Obligations to complete once started?
  - Step-in rights?
  - Relationship with “best consideration” obligations

Direct economic benefit

- As explained in C-451/08 *Helmut Müller*

  - Ownership
  - Legal rights to use for public purposes
  - Financial contribution/risk assumption
  - Economic advantage from future use or transfer

- Grey areas? – overage; nomination rights; CIL

- Works concessions: is direct economic benefit the works analogue of entrusting a service which the authority is responsible for providing (see *Ocean Outdoor*)?

- How do section 106 agreements fit in?

Control of design?

- *Helmut Müller* at [67] re “measures to define the type of the work or, at the very least . . . a decisive influence on its design”
- Only relevant to third limb of public works contract definition? – is that what catches DAs as opposed to building contracts?
- Evidential/presentational impact of close control

Main object/land transactions

- C-331/92 *Gestion Hotelera* [1994] ECR I-1329 “main object” approach to mixed contracts – see now PCR reg 4(2) and CCR regs 20(3) and (4)
- Further requirement of “indivisibility”: differing degrees of rigour in C-149/08 *Club Hotel Loutraki* and C-215/09 *Mehiläinen Oy*
- See also E-4/17 *EFTA Surveillance Authority v Norway*
- PCR reg 10(1)(a)/CCR reg 10(11)(a) – typically irrelevant in DA cases (despite what said in *Ocean Outdoor*) because authority is disposing, not acquiring
- Is real object to dispose of land or to acquire works?

Valuation of DAs

- PCR reg 6(1): total amount payable
- CCR reg 9(3): total turnover generated
- Many (most?) DAs will be concessions if caught at all – formula then clearly catches revenue from third parties [N.B. how does CCR reg 18(3) on maximum duration work in a DA context?]
- What if only a small element of the works passes the direct economic benefit test?

Exemptions (technical reasons/exclusive rights)

- PCR reg 32(2)(b)/CCR reg 31(6)(b) direct awards: typically suggested where possible DA partner is existing owner of relevant land – no reason why land ownership cannot be an exclusive right
- But frequent CJEU emphasis on strict approach to construing/applying exceptions - fact sensitive examination of:
  - Is that land really necessary?
  - Can relevant land rights reasonably be acquired by other means?
  - Does situation require award of works contract/concession and not just a land deal?
- "No reasonable alternative or substitute" – effectively a proportionality requirement
- No "artificial narrowing down" – but authority still entitled to decide nature of what it wants to procure

Article 56TFEU and *Quidnet*

- General principles of transparency and equality can apply, requiring advert and competition, to transactions of potential cross-border interest, if direct dealing would indirectly restrict the freedom to provide services
- Argument that this could apply to a DA even if absence of positive works obligations took it outside PCR (especially if it represented a unique opportunity) – rejected in *AG Quidnet Hounslow LLP v Hounslow LBC* [2013] 1 CMLR 25
- *Quidnet* appears to have stood test of time, and may now outlast TFEU in English law

“Full value” obligations and potential need to go to market

- For local authorities –

  - Local Government Act 1972 s 123; *or*
  - Town and Country Planning Act 1990 s 233

- For all authorities, need to avoid unlawful state aid which potentially results from disposal at undervalue – see especially Commission Notice on Notion of State Aid (2016/C 262/01) at paras 89-95 and 03

- Note that, in situation where true comparables are lacking, prior valuation may meet state aid concerns even without tendering, but may still leave question as to whether best consideration “reasonably obtainable” requires market testing

Guarding against ineffectiveness (1)

- What could a VEAT notice ever do for us?
  - If valid, no ineffectiveness remedy under PCR/CCR
  - And no civil financial penalty either
  - Probably available and necessary in cases of e.g. contract modification (what about PCR reg 13 subsidised contract cases?)
  - Not relevant (standstill/suspension and framework call-off grounds aside) unless the issue is failure to advertise under Directive (i.e. absence of OJEU notice); so cf. *AAEW Europe LLP v Basingstoke & Deane BC* [2019] EWHC 2050 (TCC)

Guarding against ineffectiveness (2)

- What a VEAT notice will *not* do:
  - Protect against damages claims
  - Invariably set time running
  - Automatically protect against quashing in JR, or injunctions to enforce TFEU rights (though highly relevant to exercise of discretion – cf. *Stagecoach East Midlands Trains Ltd v Secretary of State for Transport* [2019] EWHC 2047 (TCC))
  - Protect against Commission investigations and infraction proceedings
  - Protect against domestic statutory invalidity (but see LGA 1972 s 128(2))

Standards required of a VEAT notice

- What does C-19/13 *Fastweb SpA* [2015] PTSR 111 require? Necessary for review body:

  > "to determine whether [the authority] acted diligently and whether it could legitimately hold that the conditions laid down [for a direct award] were in fact satisfied"

- AG's opinion suggests key concepts are "good faith" and "due diligence"

- What does the authority have to believe about the lawfulness of its actions, and how should that be evidenced?

- "Near miss" may still help when it comes to civil financial penalty (though nominal £1 in *Faraday* a dubious decision – see discussion of "effective, proportionate and dissuasive" formula in other contexts e.g. *Susie Radin Ltd v GMB* [2004] ICR 893

Drafting and timing of a VEAT notice

- The *Fastweb* and *Faraday* standard – “clear and unequivocal explanation” allowing potential challengers to consider action “with full knowledge of the relevant facts”
- Lengthy elaboration unnecessary, but must be complete justification with enough “relevant objective detail”
- Word/character count
- Contract value in modification cases
- When to publish? – “flushing out” versus keeping the window short – terms must be sufficiently finalised to give necessary description and justification

Other potential mitigation measures

- “Relevant contract award notices”: PCR reg 93(3)
- Agreed discharge terms: PCR regs 101(5), (6)
- “Delegated compliance” – suggestion in *La Scala* case does not seem to survive C-220/05 *Auroux* [2007] ECR I-385 as a justification for direct award, but may still mitigate likelihood/consequences of challenge