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The *James Waste*[1] decision: 'nice little earner' or waste of an opportunity?

Introduction

This phrase was used by one of the witnesses for the incumbent contractor in this case.

The decision covers a number of issues in the realm of contract modification, but the main focus of this paper is the subject of economic balance: how much of a 'nice little earner' can a contract modification be before it is deemed offside?

To answer my own question, the answer is both: the incumbent did very well out of the contract modification, but the court has provided no greater clarity on the key issue.

Given the importance of contract modification in practice, and especially in the context of high-value, complex and long-term contracts, it is surprising that there is not more case law in this area.

The questions considered in this paper are questions which practitioners are frequently asked, and the stakes are high, remembering that the first ground for a declaration of ineffectiveness (**DoI**) is the fact that a contract was awarded without an advertisement:[2] An unlawful contract modification could therefore result in a DoI rendering ineffective either the modifications or (potentially) the contract as a whole[3].

The law – a reminder

It will be recalled that contract modifications, where they are "substantial"[4], are treated as if there had been the award of a fresh contract. Because no advertisement or compliant process will have preceded that award, it will be unlawful unless it falls within one of the exceptions provided for in the relevant regulations/statute.

This principle emerged from case law by way of an application of the principles of equal treatment and transparency. It is now enshrined in the EU directives and, in the UK, in Regulation 72 of the PCR[5][6]. Whether those provisions appropriately reflect the judgments of the court is a matter for another paper.[7]

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[1] [2023] EWHC 1157 (TCC); 19.5.23

[2] PCR Regulation 99(2)

[3] A subject for another paper!

[4] See PCR Regulations 72(8) and (9)

[5] and equivalent provisions in the sectoral regulations.

[6] As we will see, with one potentially significant tweak, the "economic balance" issue is retained in the Procurement Act

[7] As noted, the court arrived at its position on contract modification by reference to the principles of equal treatment and transparency

There are a number of limbs to the substantiality test as expounded in *Pressetext*[8], but the key focus of this paper is that which states that:

"*An amendment may also be regarded as being material*[9] *when it changes the economic balance of the contract in favour of the contractor in a manner which was not provided for in the terms of the initial contract*."

This dictum is reflected in Regulation 72(8) as one limb of the substantiality test, as follows:

" *the modification changes the economic balance of the contract or the framework agreement in favour of the contractor in a manner which was not provided for in the initial contract or framework agreement*"

so that, if a modification which is not saved by one of the other elements of Regulation 72 fails the test as to economic balance, it will be considered substantial and therefore as requiring the conduct of a new contract award procedure if it is to be lawful.

Accordingly, it is pivotal to know what is meant by a change in the economic balance. In particular, where a contract change involves more consideration for the contractor, less output for the same remuneration and/or payments based on a modified payment mechanism, is this *ipso facto* a change in economic balance or is more required in order for there to be a substantial change?

Little help in UK or EU case law

The leading case is, of course, *Pressetext*, which (from the point of view of price change) was straightforward as the price changes were minimal, were largely designed to deal with conversion from Austrian Schillings to Euros and were to the contractor's detriment.

There is also consideration of the issue of price change in the High Court decisions in *Edenred*[10] and in *Gottlieb*[11]; however the price change issue was not the subject of argument on appeal in the former.

The relevant elements of these cases are considered below.

The issue

What is meant by a change in economic balance? Is that balance disturbed by simply adding more turnover or profit for the contractor? Alternatively, is the balance maintained so long as any additional remuneration is calculated by reference to contractual rates or represents a reasonable or market rate for the additional works, supplies or services delivered?

There are several scenarios to consider, which I will imaginatively label Scenarios 1 to 4:

[8] Case C-454/06

[9] *Pressetext* uses the language of materiality, rather than substantiality as used in the PCR; the Classic Directive uses both!

[10] [2015] EWHC 90 (QB)

[11] [2015] EWHC 231 (Admin)

- additional works, supplies or services identical to those already provided under the contract are to be procured, to be supplied at the rates specified in the contract (Scenario 1)[12];

- provision of works, supplies or services different from those which are already provided under the contract are to be procured at a price specific to those items (Scenario 2) ;

- a change to the scope or quantity of works, supplies or services to be provided under the contract[13], either with or without an adjustment to price (Scenario 3) ; or

- a change in the contract rate without provision of any additional works, supplies or services, perhaps to reflect inflation (Scenario 4) ;

or a combination of the above. The situation in *James Waste* was a combination of Scenarios 2 and 3.

Of course, there are other bases on which such changes could be considered lawful,[14] but for present purposes, it will be assumed that none of them applies.

A few preliminary comments:

- Scenario 1 is likely to be the easiest to analyse;

- Scenario 2 and Scenario 3 with a change in price, are likely to be the hardest.

So what is a change in economic balance? It cannot sensibly refer simply to a situation in which no additional consideration changes hands, because;

- an increase in price is clearly contemplated by other provisions of Reg 72[15]

- if that had been what the Community legislature had intended it could have been dealt with much more simply than by including the somewhat Delphic concept of a change in economic balance.

Given the above, for us to conclude that there is a change in economic balance in favour of the contractor does the contract modification need to involve more profitable work or work at rates higher than those available in the market either at signing or at the point of modification? Unfortunately the caselaw is inconsistent on this pivotal issue.

The following were pointed out in the judgement in *Gottlieb*[16]:

- "*the Development Agreement, as varied, is a more favourable arrangement than the Council would be likely to obtain in the market*"

- "*the unprofitable elements of the contract were largely removed, and the Developer gained a much improved opportunity to increase its return, and thus its profit*."

- and the Court noted with seeming approval the following comment by one of the witnesses:

[12] as in Edenred

[13] as in *Gottlieb*

[14] For example, under any of Regs 72(1)(a)-(c)

[15] For example, the so-called ' safe harbour' provision in Reg 72(5)

[16] See paragraph 61

"*even if the [percentage] return intended to be achieved by the Developer does not change …, the actual profit that would be achieved would be significantly higher in absolute terms as a consequence of the changes*."

- "*The variations of the contract to remove the requirements to fund unprofitable civic amenities, if in place [when the original competition was conducted], would have provided an economic benefit to potential bidders beyond the original contract. In my view, they are material variations to the original terms which could not have been anticipated by potential bidders*."

It can already be seen that the above dicta unhelpfully involve several possible formulations as to:

- the nature of a change in economic balance, seemingly without choosing between them; and

- the time at which the change in economic balance is to be assessed.

This probably didn't matter given the facts of *Gottlieb* and in particular the very extensive nature of the modifications in that case, but it provides little clear guidance as to which yardstick is relevant in other less extreme cases.[17]

Another point which arose in *Gottlieb* was whether consideration of economic balance should take account of potential profits to be obtained from third parties, not just the awarding authority: the court considered that it should.

Turning to *Edenred*, the first point to note is that the claimant sought, somewhat late in the day, to advance financial evidence but this was based on a confusion between margin and profit, leading the court to say "*Edenred's remaining arguments on the economic balance point were…fundamentally misconceived and…based on factual misapprehensions*."[18]. The court nevertheless went on to consider economic balance[19], making the following observations:

- "*As the Defendants were able to demonstrate, the (projected) profit margin shown in the baseline financial model for the Amendment Agreement is consistent with that in the baseline financial model for the main contract*."

- "*The contractual charging mechanism remains the same under the Amendment Agreement as it is under the original Outsourcing Contract*"

- "*the services to be provided under the Amendment Agreement will be charged on the original basis set out in Schedule 5, and not on some more advantageous "cost-plus" basis as alleged by Edenred*"

- "*Atos' profit margin is susceptible to exactly the same risks under the main Outsourcing Contract and the Amendment Agreement*"

and accordingly:

"*Atos does not stand to gain any greater financial advantage from providing the [additional] supporting services under the proposed Amendment Agreement than it does under the main Outsourcing Contract*."

[17] NB the changes in *Gottlieb* were effected to render an unprofitable contract profitable (see eg para 139). On *James Waste* reasoning, would this have mattered so long as the price was reasonable /commercial?

[18] See paragraph 135 of the High Court judgement

[19] See paragraphs 136-139 of the judgment

So, as with *Gottlieb*, several potential bases for testing change in economic balance were considered, but again without choosing between them.

So, to summarise, the following possible approaches to change in economic balance and the writer's view as to their appropriateness as being the correct test are summarised in the table below:

Possible basis for considering economic balance	**Writer's view**
Deal more favourable than obtainable in the market	Irrelevant: question is whether the economic balance of this contract is altered; there is also a timing issue here
Reduction in scope entails increased profit	Seems like a suitable potential basis for test in Scenario 3 where scope reduces
Projected profit margin consistent with that in the baseline financial model for the main contract	Potentially suitable in all scenarios. Begs the question whether, if actual outturn differs from that modelled, one needs to revisit the question of economic balance
Contractual charging mechanism remains the same under the Amendment Agreement	Not appropriate in some cases: for instance, see example below this table regarding amortisation of initial capital outlay
Greater financial advantage from providing the [additional] supporting services under the proposed Amendment Agreement than under main Contract	Depends on definition of financial advantage

A not uncommon scenario which is worth pondering is one in which the contractor has made a significant capital investment (for example in equipment or premises) at the outset of the contract and is amortising that investment over the life of the contract. In such circumstances, if the term is extended or more units of goods or services are to be acquired by reason of the contract modification, it can be seen that merely applying the original unit prices set out in the original contract will result in an increase in the profit level for the contractor, and it is submitted that this must in principle constitute a change in economic balance.

The James Waste decision

All of which brings us to *James Waste*.

The case involved adjustments to a waste contract and call-offs under a complementary framework agreement to which the claimant was a party.[20]. At the heart of the case were changes to a long-term Integrated Waste Handling Contract awarded by Essex CC to Veolia.

Modification was needed because a mechanical biological treatment facility had closed, necessitating changes to the pattern of transportation and disposal of waste, including potentially longer-distance waste hauls and the use of an additional third party-operated waste transfer station.

[20] For a detailed summary of the facts, see Henty PPLR 2023/5 at NA238

Because of time pressures, the additional services were awarded direct to Veolia seemingly with little due diligence or testing of prices proposed[21]; Veolia's financial proposals were accepted without negotiation.

It is worth noting that these changes took effect for only the last 5 months of a long-term contract, so what follows is not presented by way of criticism of the outcome of the case; rather it is the approach which the court took to examine the vexed issue of economic balance which is under review, insofar as interested parties may look to that methodology for assistance in future cases.

Two elements of the modification were scrutinised by the court:

(i) a gate fee for the new waste transfer station which differed from that in the original contract; and

(ii) a guaranteed minimum mileage charge for waste hauls which deemed all waste hauls to be 38 miles when that did not accord with the factual situation.

Veolia was, of course, providing additional or modified services in return for these payments: so, as already noted, a combination of Scenarios 2 and 3 in our nomenclature.

The court could have specified, having analysed the aforementioned dicta from *Gottlieb* and *Edenred*, which approach properly represented the key to change in economic balance, but failed to take the opportunity to do so. By way of example, the court said:

"*the change may be such that the original remunerative scheme cannot simply be applied to the services or supplies contemplated by the modification. That is in fact the case here in respect of the gate fees... In such cases, where a different payment mechanism has to be adopted, there is surely force in the suggestion made at paragraph 6-277 of Arrowsmith's The Law of Public and Utilities Procurement, 3rd edition that "reasonable compensation" is the appropriate yardstick by which to judge a price increase."*

- but can this be right? Take, for example, a contract which is unprofitable because the winning bidder 'low-balled' to win it; surely, to award new work to that bidder on the basis of reasonable compensation changes the economic balance, subject to any *de minimis* argument?

This is not an observation solely limited to such circumstances but, it is asserted, demonstrates why a change in economic balance cannot be ruled out simply because the compensation stipulated in the modified contract is reasonable.

The court said that the mere fact that the original contractual payment mechanism needed to be altered to deal with features of the modification (as in this case as regards the mileage charge) was not in itself fatal. That must be right, but one might observe that in such circumstances it becomes a much more important but also difficult issue to ascertain whether there has been a change in economic balance.

The court's next point was that:

"*There must surely be a consideration of whether the change is itself justified, and again, a useful yardstick would be reasonable compensation*."

- this sentence conflates two different issues: the reason for the modification and the magnitude of the compensation. The reason for the modification is surely irrelevant. The latter element has been considered above.

[21] See for example paragraph 174 of the Judgment

De Minimis?

In *James Waste* the Court alluded to the possibility of a *de minimis* rule by quoting from Arrowsmith as follows[22]:

"*It is possible that there is also a de minimis rule that means that some small price changes are acceptable even if they alter the balance of the contract slightly in favour of the contracting partner, at least where there is a good reason to make such a change*."

It would seem sensible to permit small changes without this resulting in a disproportionate need to reprocure. This may be the reason why the Procurement Act has added the word "materially" to the provision referring to economic balance[23].

Arguably, there is some oblique support for the idea of a *de minimis* concept in *Pressetext* in which it will be recalled that the rhetorical question asked by the Court was whether the change was "*such as to demonstrate the intention of the parties to renegotiate the essential terms of that contract*"; it must surely the case that *de minimis* changes do not pass this test. And the Court noted that the changes to prices in the contract at issue in that decision were "*minimal and objectively justified*".

German law includes an express *de minimis* provision[24] as well as deploying the word "*material*".

Where one might part company with Professor Arrowsmith is in any suggestion that the reason for the change is of relevance. it should not be, unless it engages one of the other limbs of Regulation 72.

What is the correct approach?

It is suggested that:

- the reason for change should be considered irrelevant;

- reasonableness or the fact that prices accord with the current market rate should also be considered irrelevant;

- even with use of the same charging mechanism, a substantial increase to quantum of profit (even at the same percentage rate) should be considered offside, and may well also infringe Reg 72(1)(a) ("*materially different in character*") and (d) ("*extends the scope…considerably*") in any event.

As the Advocate General in *Presstext* noted:

"*Whether the alteration of a price for a part of the services to be provided constitutes a material contractual amendment depends on the significance of the price amendment in question, both in relation to the part-service concerned and in relation to the public contract in its entirety*."

It is submitted that there is a double-edged problem in modifications to unprofitable contracts:

[22] Paragraph 167 of the Judgment

[23] See Section 74(4)(c)

[24] See Section 132(3) GWB

- any non-*de minimis* profitability may be offside; but

-an incumbent contractor is unlikely to accept additional unprofitable work.

By extension, a contracting authority in a situation comparable with that in *James Waste* is likely to be unwilling to accept additional obligations without adequate recompense. The contracting authority will be unwilling to run a fresh competition even if that is practically possible, and

Longer term and complex contracts, as well as high rates of inflation in labour and raw materials rates are likely to call for contract change and render this issue more significant and harder to resolve.

Expert accountancy evidence should be sought and an economically-cogent view should be formed as to the economic balance of the contract.

Conclusion

The courts have not helped clarify what "economic balance" means, and the Procurement Act does nothing to help. It is to be hoped that guidance yet to be published will assist.

As far as the writer is aware, there is little help available in the case law or legislation of EU member states, though it is notable that (for example) Germany and Ireland have adopted legislative measures to address recent high inflation. The acceptability in procurement law of such measures is questionable.[25]

German and French law[26] both include an express *de minimis* provision as well as deploying the word "*material*". This last point results from French administrative case law[27] that the material change of the economic balance of a public procurement or a concession contract is in principle forbidden and that the economic balance must be assessed in light of the essential terms of the contract such as the term, the investment volume or the tariffs.

As a result, contracting authorities are left in a twilight zone in which it is unlikely that clear advice to the effect that all but de minimis changes are clearly lawful will be received.

Coupled with the obvious effort involved in reprocuring, and the possible consequences of early determination of the existing contract, contracting authorities are likely to be in the uncomfortable position of needing practically to extend or increase the scope of an existing contract without any comfort that in doing so it will not face a challenge risk.

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[25] See my White Paper talk from 2022

[26] See Section 132(3) GWB for German law and articles R. 2194-8 (public procurement contract) and R. 3135-8 (concession contract) of the Public Procurement Code for French law.

[27] See Conseil d'Etat (i.e., the French Administrative Supreme Court) 9 March 2018, *Compagnie des parcs et passeurs du Mont-Saint-Michel*, case No. 409972; CE 15 September 2022, No. 405540, opinion on the possible modifications of price or tariffs of public procurement contracts and the application conditions of the unforeseeability theory.