Annex to Statement of Reasons issued on 20 September 2021

Compatibility with procurement law of the modifications to the contract which were agreed by the Council in 2016 –

Summary of submissions from the council and the objectors and of the independent legal advice we have received

Summary of the Council's submissions

The Council submits that the contract modifications agreed by way of the RPP and 2016 Contract were lawful under procurement law and therefore did not constitute the awarding of a new contract without a competitive process. The Council relies on the legal principles set out by the EU Court of Justice in its judgment in the *Pressetext* case (Case C-454/06) and subsequently codified in Regulation 72 of the Public Contracts Regulations 2015 ("**PCR 2015**").

In particular, the Council relies on the *Pressetext* principle codified Regulation 72(1)(a), pursuant to which contracts "*may be modified without a new procurement procedure … where the modifications, irrespective of their monetary value, have been provided for in the initial procurement documents in clear, precise and unequivocal review clauses, which may include price revision clauses or options, provided that such clauses – (i) state the scope and nature of possible modifications or options as well as the conditions under which they may be used, and (ii) do not provide for modifications or options that would alter the overall nature of the contract*".

The 2013 Contract set out a mechanism for an RPP to be developed and agreed after the longstop date for obtaining a satisfactory planning consent had passed. The terms of the contract detailing that mechanism were set out in paragraph 3.3 of Schedule 26 to the 2013 Contract.

In the Council's submission, paragraph 3.3 of Schedule 26 constituted a "*clear, precise and unequivocal review clause*". As bidders participating in the competition for the contract were aware that the contract would include those provisions, the opportunity to develop and agree an RPP with the Council in circumstances where the longstop date passed without a satisfactory planning consent having been obtained was part of the contract opportunity that was subject to competition. According to the Council, paragraph 3.3 sets out "*clear express restrictions*" as to the modifications that could be made by way of an RPP, "*including the need to take account of procurement law, obtain best value for money, minimise cost increase, maximise cost reduction and to act at all times in a cost-effective way*" (letter from the Council dated 18 February 2021). Paragraph 3.3 identified the scope and nature of possible modifications or options as well as the conditions under which they could be used and did not provide for modifications or options that would alter the overall nature of the contract.

In support of these arguments, the Council draws an analogy with the facts of the *Edenred* case in which the UK Supreme Court analysed contract change provisions in a contract for the provision of outsourced IT services required by National Savings & Investments ("**NS&I**"): *Edenred (UK Group) Ltd v HM Treasury* [2015] UKSC 45.

In the alternative to relying on the *Pressetext* principle codified in Regulation 72(1)(a), the Council relies on the *Pressetext* principle codified in Regulation 72(1)(e) pursuant to which contracts "*may be modified without a new procurement procedure … where the modifications, irrespective of their value, are not substantial within the meaning of paragraph (8) [of Regulation 72]*". Paragraph (8) sets out a list of situations in any of which a modification will fall to be considered "substantial". One of those situations is where "*the modification changes the economic balance of the contract … in favour of the contractor in a manner which was not provided for in the initial contract*" (sub-paragraph

(d) of paragraph (8) of Regulation 72).

In the Council's submission, the modifications that were agreed in 2016 were "not substantial" and were therefore compatible with procurement law based on Regulation 72(1)(e). In that regard, the Council contends that the modifications did not change the economic balance of the contract in UBB's favour, but rather "*the economic balance moved in favour of the Council*" (letter from the Council dated 18 February 2021). According to the Council, that conclusion is supported by comparing UBB's Base Case Equity Internal Rate of Return (IRR) in 2013 with the equivalent figure in 2016. This information was shown in the definitions of "Base Case Equity IRR" in Schedule 17 to the 2013 Contract and the 2016 Contract respectively. UBB's projected return fell from 12% in 2013 to 10.77% in 2016 (both real). Given that the contract was for a PFI project, the Council had full visibility of UBB's financial model for the project and is therefore able to assess the economic balance of the contract throughout.

Summary of the objectors' submissions

The objectors submit that paragraph 3.3 of Schedule 26 to the 2013 Contract was insufficiently prescriptive as to the modifications, including as to prices, which could be made through the process of negotiating and agreeing an RPP to come within Regulation 72(1)(a). In contrast with the provisions of the 2013 Contract which set out methodologies for making certain adjustments to be made to prices etc. to take account of changes in circumstances where satisfactory planning consent was obtained before the longstop date, paragraph 3.3 could potentially allow a wide range of changes to be made to the contract (albeit that paragraph 3.3.2 provided that UBB should, in preparing the draft RPP, "*be cognisant of procurement law*"). Paragraph 3.3 therefore did not constitute a "*clear, precise and unequivocal review clause*".

With regard to Regulation 72(1)(e), the objectors submit that the modifications agreed in 2016 were "substantial" changes. In particular, the objectors submit that the modifications clearly did alter the economic balance of the contract in UBB's favour. In support of that conclusion, the objectors make a number of specific points, including the following:

(a) There was a significant increase in the projected value of the contract, which rose from £450m over 25 years, to £613m over 25 years. This difference cannot be accounted for by inflation in costs due to a 3-year delay.
(b) The cost to the Council of dealing with residual waste under the contract, on a price per tonne basis, is high by comparison with the average gate fees being paid by other councils (as captured by WRAP's 2019 gate fees report) and appears also to exceed the cost of landfill disposal. This indicates that UBB receives excessively high remuneration under the terms of the 2016 Contract.
(c) At a meeting of the Council's OSM Scrutiny Committee on 22 March 2019 the Council's Chief Executive observed that half of the increase in the projected costs of the project to the Council related to the fact that the contractor was in "*an advantageous position*". This suggests that the 2016 modifications shifted the economic balance of the contract in favour of UBB and not in favour of the Council.
(d) The 2013 and 2016 Base Case Equity IRR figures relied on by the Council do not constitute an appropriate or robust basis for concluding that, if the contract changes agreed by way of the 2016 Contract changed the balance of the contract, they did so in the Council's favour.

Summary of the independent legal advice we have received

We sought advice on public procurement from specialist counsel. Counsel has considered the relevant submissions of the Council and the objectors and has advised as follows:-

The Council's reliance on the *Pressetext* principle codified in Regulation 72(1)(a) is not legally sustainable, since paragraph 3.3 of Schedule 26 to the 2013 Contract does not, on proper analysis, constitute a "*clear, precise and unequivocal review clause*".

Paragraph 3.3 is framed in broad terms and could (at least absent constraint from procurement law)

potentially permit very extensive modifications to the project plan, allocations of risk, and/or remuneration, as the outcome of a process of negotiation between the Council and UBB. The parties could potentially negotiate and agree with one another a substantially new set of contractual terms in replacement for their original bargain (which reflected the terms on which UBB bid for, and won, the original contract).

Whilst the Council has submitted that paragraph 3.3 heavily prescribed the changes that could be made by way of a RPP, close analysis of the precise terms of that paragraph does not, in Counsel's view, support that submission. In that regard:

(a) The list of aspects of the project to be set out in an RPP is extensive and broad: see paragraph 3.3.3.

(b) Paragraph 3.3.2 required UBB to comply with certain general principles when preparing the draft RPP: UBB should "*be cognisant of procurement law, act in good faith and comply with Good Industry Practice with the objective of ensuring that it obtains best value for money for the Authority (taking into account all relevant circumstances including the requirement that [UBB] should be no worse off as a result of the implementation of the [RPP] …) when procuring any works, services, supplies, materials or equipment required in relation to the revised Project*".

(c) Paragraph 3.3.4 required the Council and UBB to discuss and seek to agree each and every element of the draft RPP including "*the provision of evidence that [UBB] has used reasonable endeavours (including (where practicable) the use of competitive quotes) to oblige its Sub-Contractors to minimise any increase in costs and maximise any reduction in costs*" and "*demonstrating how any Capital Expenditure to be incurred or avoided is being measured in a cost effective manner*".

(d) However, paragraphs 3.3.2 and 3.3.4 did not prescribe specific constraints as to the changes that could be made. Nor did those paragraphs provide a methodology for determining how any agreed changes in the specifications for, or other aspects of, the project would affect the allocations of risks or the remuneration payable.

(e) The substance of the arrangements provided for in paragraph 3.3 for the development and agreement of an RPP was that there would be a process of negotiation between UBB and the Council based on a draft RPP that UBB would prepare. The principal constraint on the changes that could be agreed by way of the final RPP, and the impacts on the changes on the economic balance of the contract, was the willingness of the parties to agree to one another's proposals.

The analogy that the Council has sought to draw with the facts of the *Edenred* case is inapposite. It is apparent from the judgment of the Court of Appeal in that case ([2015] EWCA Civ 326), at paragraphs [77]-[78], that in that case:

(a) The contractor (Atos) was "*obliged to accept any changes to the services to be provided pursuant to the contract*" except in certain specified circumstances (such as where accepting the changes would adversely affect health and safety).

(b) The contract change provisions in the contract were intended to enable the services to be provided by Atos to be extended to take account of future expansion of the activities of NS&I into providing 'business-to-business' ("**B2B**") services, and were not such as to demonstrate an "*intention to renegotiate the essential terms of the contract*".

(c) The contract provided "*a fixed price formula for future B2B services*".

The Supreme Court found that the expansion of the services provided under the Atos contract was lawful in a set of factual circumstances in which the contract not only envisaged the expansion, but also committed Atos to providing the additional services and required it to have the resources to do so ([2015] UKSC 45, *per* Lord Hodge at [34] & [36]). Specifically with regard to whether the contractual terms permitting the changes constituted "*clear, precise and unequivocal review clauses*", the Supreme Court observed that the Atos contract "*set out the principles that governed the incorporation of a new B2B service into the agreement, inter alia restricting any increase in Atos' profit margin and prohibiting the alteration of the allocation of risk*" (*per* Lord Hodge at [43]-[45], see also [13]).

The Council *may* be correct in its alternative submission that the modifications were lawful based on the *Pressetext* principle codified in Regulation 72(1)(e); however, this depends on whether the modifications altered the overall economic balance of the contract in UBB's favour.

Grant Thornton has not obtained material, or carried out analysis, which is sufficient to enable it properly to reach a conclusion as to whether the economic balance of the contract changed, and if so, in whose favour it changed. The modifications were extensive, and any assessment of whether the overall package of modifications altered the economic balance of the contract could only be reached on the basis of a detailed assessment taking into account each of the modifications, the reasons for those specific modifications, and any changes in how risks were allocated.

The Council has pointed to evidence, in the form of comparisons between the 2013 and 2016 Base Case Equity IRR percentage figures, to support a conclusion that the balance of the contract in fact shifted in the Council's favour. Grant Thornton has not, however, sought to test the underlying assumptions used to arrive at those percentage figures. The Council has not provided Grant Thornton with a detailed analysis of the contract modifications made in 2016 and how those modifications, seen as a whole, did not change the economic balance of the contract in UBB's favour.

The objectors, in contrast, have pointed to factors suggesting that the economic balance shifted in UBB's favour. The fact that the Council's advisers, EY, appear to have focused on assessing whether the RPP represented value for money for the Council *as compared with the alternative option of cancelling the contract and incurring consequential costs* could also suggest (but does not in itself establish) that the modifications could have tilted the economic balance of the contract in UBB's favour. The objectors have fairly observed that they are not in a position to themselves present a detailed analysis of the contract modifications made in 2016 and how those modifications, seen as a whole, affected the economic balance of the contract, as the objectors do not have access to the information and documents needed for carrying out such analysis.

The Council has not provided Grant Thornton with evidence showing that it contemporaneously assessed whether the package of modifications altered the overall economic balance of the contract in UBB's favour, prior to agreeing those modifications. Whilst the Council was, when negotiating with UBB in relation to the draft RPP, assisted by various technical and legal experts, their focus appears to have been on securing the 'best value' outcome available for the Council in the circumstances, from an economic and budgetary perspective, given the practical options available to the Council at the time. That is a materially different focus from assessing whether the modifications changed the economic balance of the contract.

UBB would, when negotiating with the Council over the RPP, have known that the termination of the contract would be a costly and inconvenient option for the Council, since the Council would, in those circumstances, have had to: (a) embark on a new competitive process for letting a new contract, which could be costly and involve years of delay; (b) find alternative ways to deal with waste in the meantime, which could also be more costly; and (c) pay the Force Majeure Termination Sum. These factors could have placed UBB at a negotiating advantage *vis-à-vis* the Council. These considerations do not, however, suffice in themselves to demonstrate conclusively that the modifications changed the economic balance of the contract in UBB's favour, rather than raise a real possibility that the economic balance was so changed.

Counsel has reached that view notwithstanding that the Council appears to have agreed the modifications without making a prior assessment as to whether the modifications altered the economic balance of the contract. In Counsel's view, the Council's failure to carry out such a contemporaneous assessment means that it did not properly satisfy itself that it had a sound basis for deciding that it was acting lawfully in agreeing the modifications. EU procurement law includes, and its interpretation and application is heavily informed by, the principle of "transparency" derived from the free movement provisions of the TFEU. An aspect of that principle is that a contracting authority should keep records so as to enable the lawfulness of its procurements subsequently to be verified. Where an authority relies on an exception from a general rule (e.g. the general rule that contracts should not be altered during the contract term), then it should be able to provide evidence supporting the conclusion that the exception was validly relied upon. Ideally, that evidence should be contemporaneous. In this case, however, it is fair to observe that the Council's failure to make a contemporaneous assessment may be explicable on the basis that the Council understood the modifications to be permissible under Regulation 72(1)(a), so that it was not necessary to consider whether the modifications altered the economic balance of the contract.

The fact that the Council may not have properly satisfied itself, at the time, that it was acting lawfully does not necessarily mean that the modifications in fact altered the economic balance in the contractor's favour and thus breached procurement law. In other words, the fact that a contemporaneous assessment was not made by the Council does not mean that Grant Thornton, or indeed a court, could simply *assume* that the modifications changed the economic balance of the contract in UBB's favour. A retrospective assessment would still be required, albeit that a retrospective assessment made by the Council itself might be viewed with a degree of circumspection given that it would not be a contemporaneous assessment but would be seeking to justify a decision that the Council had already taken.

It would be very difficult for Grant Thornton now to determine whether the modifications altered the economic balance of the contract and, if so, in whose favour. As noted above, a conclusion that the economic balance was so changed could properly be reached only as the outcome of a detailed investigation considering the specific modifications that were made, the reasons for those modifications, any changes to how risks were allocated, etc. Such an investigation might need to test certain assumptions relied on in 2016 in relation to, for example, how costs of certain inputs had risen or were likely to rise. Such an assessment, carried out retrospectively after some four years have passed, would be a time-consuming, complex and expensive exercise requiring the involvement of experts from multiple disciplines (e.g. project management, construction, finance, planning law, etc.). Even if a great deal of time and money were expended on that exercise, it might well fail to produce a clear conclusion as to whether the economic balance of the contract was changed.