Real estate and public procurement

Mark Bassett reports on the Court of Appeal's findings in Faraday

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Those who are involved with public sector regeneration and development projects will be interested to learn about the important developments concerning the interface between public procurement law and property law, as explored in the *Faraday* Court of Appeal judgment (*Faraday Development Ltd v West Berkshire Council* [2018]).

The earlier High Court judgment (which I previously wrote about in 'Procuring clarity', *PLJ*347, December 2016/January 2017, p6) was significant insofar that it provided a relatively detailed analysis of a 'conditional land sale agreement' (CLSA) from a procurement perspective. The judgment was welcomed by authorities involved in such projects as it gave a clean bill of health to CLSAs, even where drawn-down phases contained obligations to build out.

The Court of Appeal judgment overturned that original decision, and found that the contractual arrangement between West Berkshire District Council and St Modwen (as the appointed developer) should have been procured in accordance with the Public Contracts Regulations 2015. However, it still appears to leave scope to structure property transactions so that they fall outside of the procurement rules.

Background

The project involved development land known as the London Road Industrial Estate (LRIE), the majority of which is owned in freehold by the council. Faraday Development Ltd owns a number of plots of the LRIE on long lease from the council and had an option to acquire another. The long leases produced a modest income for the council, but had little scope for increase in the foreseeable future, without redevelopment.

Faraday had been granted a planning permission for a mixed-use development on its land and sought to consolidate and extend its long leases for the plots in its ownership; however, negotiations with the council were unsuccessful.

The council then held a competition to appoint a development partner to regenerate and maximise its return from the LRIE. Faraday participated in the competition with two subsidiaries owned by Barratt Developments. Faraday played a limited role in the bid, supplying the land at a reduced cost in return for a share in the profits, and some rights to carry out residential development in the event that the bid was successful.

The council set out its requirements for the project in an estates brief (later supplemented by a number of documents), which established the basis on which the selection decision was to be made. This stressed the long-term nature of the project and looked to assess the risk associated with the development proposals and the skills of the developers. Although the council's advisers considered that there was little to choose between the bids submitted by Barratt/Faraday and St Modwen, they ultimately determined that the St Modwen bid represented the better offer.

On hearing that its bid had failed, Faraday challenged the decision to enter into the agreement on the basis

that it should have been subject to the Public Contracts Regulations and was therefore unlawful. In the High Court Faraday also challenged on the basis that the council had failed to get the 'best consideration reasonably obtainable' under s123 of the Local Government Act 1972, and also claimed that the decision was 'irrational' on public law grounds, but these points were not the subject of the appeal.

Contractual framework

The draft development agreement agreed between the council and St Modwen contained the following key features:

- the main objective of the agreement was the regeneration of the LRIE in a manner which maximised a sustainable return to the council;
- it established a deadlocked steering group (SG) on which the council and St Modwen were represented by two members each;
- St Modwen was obliged to undertake a business plan and master plan for the whole site, setting out development plots, land to be retained, and any infrastructure works necessary to facilitate development for approval by the SG;
- St Modwen was then obliged to prepare a cost budget for the works, for approval by the SG, and, if approved, obtain an outline planning permission for the whole site;
- St Modwen was then to develop a strategy document for each of the plots for approval by the SG, which, once obtained, triggered a 'reasonable endeavours' obligation to secure a detailed planning permission for the works covered by the strategy;
- subject to a final financial appraisal being approved by the SG, and any pre-commencement conditions specified by the council being met or waived, St Modwen could then draw down the land; and
- if St Modwen opted to draw down the land, the ground lease (or freehold transfer) would include terms which oblige St Modwen to develop out the scheme in accordance with the approved plan for the plot.

Publication of a voluntary ex-ante transparency notice (VEAT notice) in respect of the project

Interestingly, the council pleaded an argument in the Court of Appeal that they had not relied on in the High Court, namely that the publication by the council of a VEAT notice acted to prevent the remedy sought by Faraday of 'contractual ineffectiveness'.

The Public Contracts Regulations provide that where a VEAT notice had been published, and no claim issued within ten days of the publication, then the ineffectiveness remedy is not available. However, there are a number of conditions which must be complied with before a VEAT notice will offer this protection to a contracting authority.

Findings of the Court of Appeal

In allowing the appeal Lindblom LJ, who gave the lead judgment, made the following points:

- At the outset, the agreement between the council and St Modwen was not a public works contract. St Modwen is only under a contingent obligation to carry out works – without a direct or indirectly enforceable obligation, the contract lacks an essential element of the 'public contract' that would engage the requirements of the public procurement rules.
- Nevertheless, the arrangement was, in this case, unlawful because when the commercial substance of the transaction was considered, it should have been considered to be a public works contract. This was because 'the Council had committed itself contractually, without any further steps being necessary' to enter into a transaction that would have the characteristics of a public works contract. By this Lindblom LJ meant that St Modwen would have been responsible for the steps of preparing a business plan, setting a cost budget and developing a strategy document, which would ultimately lead to St Modwen obtaining land under a lease for a specific phase of the development. The key problem being that this lease also contains an obligation to build out the phase, thus satisfying the requirement that public works contracts contain an obligation to deliver works.

  By entering into an arrangement which facilitated an end point where there was a contract which contained an obligation to build to a specification substantially approved by the council, the council had breached public procurement law.

- Helpfully Lindblom LJ refused to find that in attempting to structure the project in a way which did not engage the public procurement regime, the council was doing something inherently wrong or that was a 'sham' or an 'abuse of rights'. There was no evidence that the council acted in bad faith, or that the arrangement was one which was created to disguise the economic and commercial reality of the transaction. Had Lindblom LJ found in favour of this element of the claim it would have resulted in significant uncertainty for

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many local authority real estate transactions.

- The judgment also stated that the contract could not be considered to be a contract for services, notwithstanding the obligations on St Modwen to create a master plan for the whole site, setting out development plots and a business plan. Notwithstanding arguments that the contract had characteristics of a services contract (an obligation and defined specification of services), he ruled that there was no separate services contract. The services element of the development agreement was ancillary to the main purpose of the contract, which was to facilitate development.

- Lindblom LJ ruled that the VEAT notice published was ineffective and did not offer protection for the council. He identified two flaws. Firstly, without sight of legal advice concerning the publication of the VEAT notice it was impossible to establish whether the council had acted diligently in seeking to determine whether it was correct in its view expressed in the VEAT notice, that the contract should properly be excluded from the procurement regime. Secondly, the description in the notice was not actually accurate in terms of its description of the transaction. It did not refer to the fact that the agreement did contain contingent obligations on St Modwen. These weaknesses meant that the VEAT notice did not prevent the remedy of ineffectiveness being applied.

Flaux LJ agreed with Lindblom LJ's judgment and Lewison LJ agreed on all points except the 'abuse of rights' argument where he preferred not to express an opinion.

Commentary

The final judgment of the Court of Appeal is not entirely a surprise (indeed I anticipated concerns around this aspect of the High Court judgment in *PLJ*347). There are, however, some other noteworthy features of the judgment:

- Overall, it leaves open the possibility for local authorities to enter into CLSA-type agreements where a developer is required to fulfil certain conditions before it may drawdown the land for development. The key risk identified in the ruling is that an arrangement that contains obligations to carry out the development, at any stage, could move the arrangement into the territory of public procurement. An arrangement which provided that a drawdown lease would be terminable if works were not started (or completed) within a certain timeframe would, following the key European Court of Justice decision in *Helmut Müller GmbH v Bundesanstalt für Immobilienaufgaben* [2010], still be a sound basis for encouraging developers to get on with the business of building, without triggering procurement concerns (depending on the overall context and terms of the transaction).

- Lindblom LJ's obiter comments concerning the non-application of the public procurement rules to planning agreements seem to go beyond what the law was previously understood to be in this area. While the *Helmut Müller* case did identify specific exceptions relating to the exercise of planning powers, Lindblom LJ appears to suggest that merely badging an agreement as a 'section 106 agreement' is sufficient to take it outside the scope of the procurement regime. He appeared to rely on this distinction to differentiate the contingent obligations which are typically present in section 106 agreements (which bite if a developer commences development) and those found in the drawn-down lease in the development agreement between the council and St Modwen. This is a slightly unsatisfactory aspect of the judgment. Section 106 agreements which overreach in terms of their delivery obligations could still be at risk of procurement challenge.

- In relation to the finding that the services element of the development agreement (relating to masterplanning etc) was ancillary to the main purpose of the agreement, which was ultimately found to be that of a 'public works contract' – it is interesting to speculate what this might mean in situations where the main purpose of the agreement is 'land disposal' and does not involve a public contract. If such services obligations are ancillary to a land disposal agreement which is not a public contract then it might be argued that they could not pull a contract within the scope of the procurement regime.

- Contracting authorities will be relieved to hear that the court reportedly decided that the civil financial penalty that the court must impose alongside a 'declaration of ineffectiveness' was only £1. One imagines that the court considered that the costs to the council of undoing this arrangement (not to mention the legal fees and officer time) will be punishment enough for the council, noting Lindblom LJ's comments that there was no 'sham' or avoidance element in this case. ■

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Faraday Development Ltd v West Berkshire Council
[2018] EWCA Civ 2532

Helmut Müller GmbH v Bundesanstalt für Immobilienaufgaben
[2010] EUECJ C-451/08

R (Faraday Development Ltd) v West Berkshire Council
[2016] EWHC 2166 (Admin)