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Contract adjustments and public procurement: an analysis of the law and its application

Introduction

This focus of this paper is on the public procurement law applicable to situations in which contracting authorities seek to adjust the provisions of their existing contracts. The scope of the investigation is limited to law applicable to contracting authorities within England and Wales.[1]

Contracting authorities may need to adjust contracts during their term and where there is uncertainty as to whether or not an adjustment can be lawfully made difficulties can arise.

Where a clear legal framework exists contracting authorities and those advising them may be better placed to understand and apply the law and arguably the objectives of the contracting authority will be better met. Where there is ambiguity contracting authorities may be uncertain as to how to proceed so as to ensure their objectives are met within the parameters of the existing law, and this may result in practical difficulties as, for example, a contracting authority may decide not to make an adjustment which, had it been made, may have resulted in a better outcome for the contracting authority.

The author is in the second year of a part time PhD at the University of Nottingham, researching adjustments to public contracts. This research will firstly identify and analyse the law in this area. An aim of this section of the research will be to attempt to provide a definition of "adjustments" and to present and explain a system of categorising adjustments. It is hoped that this will assist the wider understanding of contract adjustments. A survey of

[1] Throughout this study "UK" is used to refer to this jurisdiction as in many cases the law discussed is applicable throughout the UK;

the practical application of the law in respect of contract adjustments will then be undertaken. The definition and categorisation of adjustments will provide a platform for this element of the research. The study will conclude with suggested ways in which the law could be clarified or developed to achieve a legal framework which is better equipped to meet the objectives of those seeking to apply it.

The practical element of the PhD study requires qualitative empirical research to be undertaken with the objective of understanding how the law is applied in practice by contracting authorities.

The first section of this paper provides background as to the legal framework applicable to contract adjustments, and the potential objectives of contracting authorities in public procurement and a brief explanation of the requirement for contract adjustments. The paper then explains the proposed approach to the qualitative empirical research. The method for this is at an early stage, but the proposed approach will be set out. Finally, the paper explains the approach the author has used to define contract adjustments, and to categorise types of adjustments which may be required or occur during the term of a public contract.

Background: Legal framework and requirement for contract adjustments

Legal framework

A legal framework exists to regulate public procurement which has the objective *inter alia* of preventing discrimination on the grounds of nationality within the EU and opening the EU market to intra-community competition.

The law applicable to public procurement undertaken by contracting authorities within the UK derives from the TFEU[2], Directive 2004/18 EC[3] and Directive 2007/EC[4] and the case law of the CJEU. There are no provisions in the TFEU or either directive explicitly relevant to contract adjustments. The principles of equal treatment, transparency, and proportionality are relevant to contract adjustments.

The European Commission published its proposals on the reform of the law on public procurement in December 2011.[5] At the time of writing this paper, the New Directive is awaiting publication in the Official Journal of the European Union, and this is anticipated to occur before the end of March 2014. The New Directive differs from the Directive in that it contains provisions dealing with contract adjustments. Article 72 of the New Directive sets out the circumstances in which a public contract can be "modified" without a new procurement procedure.[6] The clarification of these conditions is expressed to take into account the relevant case law of the CJEU.[7] The New Directive will require implementation in the UK before it becomes part of the legal framework applicable to contract adjustments in that jurisdiction.

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[2] Consolidated Version of the Treaty on the Functioning of the European Union (TFEU), Official Journal of the European Union, C 83/47, 30.3.2010, Article 34 TFEU, concerning the free movement of goods, Article 49 TFEU on the freedom of establishment and Article 56 TFEU concerning the freedom to provide services. Note Article 18 TFEU sets out a general prohibition on discrimination on grounds of nationality. However Articles 34, 49 and 56 TFEU will apply in their respective areas of operation so reliance on Article 18 TFEU will be unnecessary, see para 28, Case 305/87 *Commission v Hellenic Republic*, also at para 12 which cites Case 2/74, *Reyners v Belgium*, Case 13/76, *Dona v Matero*, and Case 90/76, *van Ameyde v UCI*;

[3] Directive 2004/18 EC of the European Parliament and the Council of 31 March 2004 on the co-ordination of procedures for the award of public contracts (the "Directive");

[4] Council Directive 89/665 on remedies (as amended by Directive 2007/63 EC) on the co-ordination of laws, regulations and administrative provisions relating to the application of review procedures to the award of public supply and public works contracts (89/665/EC) (OJ L 395, 30.12. 1989, p. 33) (the "Remedies Directive"); The Directive and the Remedies Directive have been together implemented in the UK in the Public Contracts Regulations 2006;

[5] Proposal for a Directive of the European Parliament and the Council on public procurement, Brussels, 20.12.2011 COM (2011) 896 final, 2011/0428 (COD) as revised: Council of the European Union, Proposal for a Directive of the European Parliament and the Council on public procurement, Brussels, 24.07.2012, 2011/0438 (COD) (the "New Directive");

[6] New Directive, Article 72;

[7] Proposal for a Directive, 20.12.2011, recital 45, p. 62;

The case law of the CJEU is of particular importance to contract adjustments,[8] and the case of *Pressetext* is the leading authority on contract adjustments. This case concerned a contract for press agency services that existed between the Austrian Republic and APA that was subject to various adjustments during its term.[9] In 2004 a company called Pressetext Nachrichtenagentur GmbH offered news agency services to the Austrian Republic but this did not lead to the conclusion of an agreement.[10] Pressetext Nachrichtenagentur GmbH subsequently challenged the adjustments that had been made to the existing contract between the APA and the Austrian Republic, contending that the adjustments were unlawful.[11]

The CJEU considered the various adjustments and stated the following:

> "*In order to ensure the transparency of procedures and equal treatment of tenderers, amendments to the provisions of a public contract during the currency of the contract constitutes a new award of contract within the meaning of Directive 92/50 when they are materially different in character from the original contract and, therefore, such as to demonstrate the intention of the parties to renegotiate the essential terms of that contract*."[12]

For ease of reference, the above will be referred to as the "*Pressetext* Test".

The CJEU then set out three examples of "amendments" that may be regarded as material:

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[8] For a summary of relevant case law see Hebly, J. M. and Heijnsbroek, P., "When amending leads to ending: a theoretical and practical insight into the retendering of contracts after a material change", in Gustavo Piga and Steen Treumer (eds), The Applied Law and Economics of Public Procurement: the economics of legal relationships, Routledge, 2013, pp. 163-184;
[9] Case C-454/06, *Pressetext Nachrichtenagentur GmbH v Republik Osterreich (Bund) and Others ("Pressetext")*, para 8-27;
[10] *Pressetext*, para 24;
[11] *Pressetext*, para 25;
[12] *Pressetext*, para 34;

"*... when it introduces conditions which, had they been part of the initial award procedure, would have allowed for the admission of tenderers other than those initially admitted or would have allowed for the acceptance of a tender other than the one initially accepted*".[13]

"*when it extends the scope of the contract considerably to encompass services not initially covered*".[14]

"*...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*".[15]

The *Pressetext* Test provides rules that must be applied by contracting authorities when ascertaining what adjustments are lawful without a new contract that may require a new award procedure either under the TFEU or the Directive, and the examples from *Pressetext* are also of importance. However, as will be in practice it may be difficult to determine what is acceptable and what is not, and this will be explored in the empirical study.

Requirement for contract adjustments

The performance of a contract constitutes a critical part of the functioning of the procurement system as it is in this phase that the goods, works or services are delivered so as to enable the contracting authority to fulfil its functions.

Contract adjustments may be required for legitimate purposes and may be critical to the continued delivery of the public contract. Given that, from the perspective of contracting

[13] *Pressetext*, para 35;
[14] *Pressetext*, para 36;
[15] *Pressetext*, para 37;

authorities, service users and tax payers, the prime purpose of public procurement is to ensure the contracting authorities continue to perform their functions it is important to recognise the impact on project delivery when considering contract adjustments.

However, contract adjustments may frustrate the principles of equal treatment and transparency. They have the potential to undermine the competition under which the relevant contract was awarded, [16] and adjustments may conceal corrupt practices.

Where contracting authorities adjust a contract other than in accordance with the applicable law, they may be subject to challenge.

Approach to empirical study

The author proposes to conduct a series of semi structured interviews with practitioners who advise contracting authorities on contract adjustments and to ask contracting authorities[17] to complete a short survey.[18] The aim is to use the responses to further expose the current legal position in terms of the way that the law is applied in practice, and also to explore whether the respondents feel the existing legal framework meets their requirements.

[16] Auricchio, V., "The problem of discrimination and anti-competitive behaviour in the execution phase of public contracts", *Public Procurement Law Review*, 1998, 5, pp. 113-130;

[17] It should be noted that within contracting authorities there will be a mix of employees who have qualified as solicitors, and other employees who have other areas of expertise, advising in relation to public contracts. It is proposed not to distinguish between these for the purposes of this study, as some qualified solicitors may not have procurement law expertise, and some of those employees who are not qualified solicitors may have legal qualifications and a high degree of understanding of procurement law issues;

[18] Respondents will be identified using available lists of existing PFI projects, websites, and in the case of external legal advisers, industry directories such as the Legal 500;

The author proposes that the scope of the research is restricted to those contracts subject to the full requirements of the public procurement regime.[19] In particular, this study focuses on contracts awarded by contracting authorities which can be categorised as Public Private Partnership (PPP) contracts.

There is no commonly understood definition of a PPP contract. PPP can be understood as a model of joint working and risk sharing between the public and provide sectors.[20] The PPP projects considered in this study will be those of a longer duration where there is a degree of complexity. A PPP project Within the UK, Private Finance Initiative (PFI) is a type of PPP arrangement.[21]

For the purposes of this study PFI has been specifically identified within the broader category of PPP firstly because PFI is funded by external funders and this may be relevant to the issue of contract adjustments. Secondly, external legal advisers may develop a specialism in PFI and it may be appropriate to also make this distinction when conducting this empirical research to better understand and categorise the types of projects respondents have advised in connection with, so as to assist in avoiding errors in data collection.

It is not relevant for the purposes of this study to separately define and consider other types of PPPs.

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[19] The public procurement regime applies in full to above threshold contracts entered into for the supply of goods, works or services (excluding Part B services which are subject to a more limited regime);

[20] HM Treasury, A new approach to public private partnerships, December 2012, p. 5;

[21] Within the UK common forms of PPP arrangements have been identified as: contracting out; PFI (including concessions); institutionalised PPPs (IPPPs) and; development agreements, see Craven, R., *Procurement procedures under the Private Finance Initiative: the operation of the new legal framework*, Thesis submitted to the University of Nottingham for the degree of Doctor of Philosophy, November 2011, p. 20;

PFI and PPP contracts have been used to deliver projects across a range of sectors including infrastructure, health care, defence and education.[22] It is proposed that the focus of the investigation will be limited to accommodation based projects in the education, health and leisure sectors.

For the purposes of this study "accommodation based projects" are those that include the design and construction of an asset (for example a school, hospital, or leisure centre) and a degree of maintenance of and/or operation of that asset for the term of the contract. Accommodation based projects are therefore "mixed" procurements in that they contain elements of works and service provision, and will be above threshold given the cost of the construction of the asset and the value of the service provision over the term of the contract. This study will focus on the delivery of these projects using PFI and PPP contracts.

These sectors have been selected because of the existence of accommodation based projects, which have a degree of similarity such as to better enable meaningful data to be collected. It is submitted that if sectors with significant differences between them were selected this may extend the scope of the survey beyond what is manageable for a study of this type.

Projects selected in this sector which are delivered by PFI or PPPs are likely to be of a complex nature and long duration.[23] It is hypothesised that it is more likely that adjustments will be required over the term of such contract compared to, for example, a simple short

[22] Arrowsmith, S., "Public Private Partnerships and the European Procurement Rules: EU Policies in Conflict?", *Common Market Law Review*, 2000, 37, pp.709-710;
[23] The duration of PFI and PPP contracts can be found in the Partnerships UK project data base – see www.partnershipsuk.org.uk/puk-projects-database;

term service contract or a contract for the supply of goods. This makes them more relevant to this study.

Adjustments: a definition and categorisation

This paper looks specifically at adjustments made during the term of contracts entered into by contracting authorities.

For the purpose of this paper an adjustment is:

> *an event which causes the performance of or a provision of an existing contract to be different to the performance or provision before the occurrence of the event. Such event can be the operation of a provision of the contract, an external event, or the performance or acceptance by a party of an obligation in a manner which differs from that provided for in the contract as awarded*.

The term "adjustment" has been selected as it is conceptually more neutral than other terms available in the context of public procurement or UK contract law more generally, and as such appears to give a better platform from which to analyse a range of scenarios which may take place or be required during the term of a contract. It is also desirable to use the same term for the purposes of consistency.

Other terms available and referred to in case law and literature include "amendment" and more particularly "material amendment", "variations", "adjustments" and "changes". It appears that the courts and academics generally do not make a distinction in definition

between these different terms.[24] This perhaps reflects the fact that in common usage in English language some of these terms are synonymous to a greater or lesser extent. However it is unhelpful to substitute the various terms without distinction as this does not lead to clarity.

A categorisation of contract adjustments has been adopted to allow for general principles to be extrapolated in so far as this is possible. Three categorisations have been adopted (i) contract adjustments made pursuant to review clauses; (ii) contract adjustments that are made in response to or as a consequence of an operation of law; and (iii) contract adjustments other than (i) and (ii). The types of adjustments falling in each category are set out and explained below.

Contract adjustments: review clauses

Review clauses are terms included in contracts providing for adjustments to be made during the term of the contract. Contracting authorities often incorporate review clauses in contracts in the understanding that they offer flexibility to allow modification of contract performance over the term of the contract.

[24] For example, *Pressetext* as described further in subsequent paragraphs; Auricchio, A., "The problem of discrimination and anti-competitive behaviour in the execution phase of public contracts", *Public Procurement Law* Review, 1998, 5, pp. 113-115 using the terms "changes" and "variations" in the opening paragraphs in which the author describes the issue upon which he is writing, and "modifications" is subsequently used as a subject heading under which examples are set out; Treumer, S., "Regulation of contract changes leading to a duty to retender the contract: the European Commission's proposals of December 2011", *Public Procurement Law Review*, 2012, 5, pp. 153-166, uses "changes" throughout; Poulsen, S. T., "The possibilities of amending a public contract without a new competitive tendering procedure under EU law", *Public Procurement Law Review*, 2012, 5, pp. 167-187, use of "amendment"; Harlev, K., and Liljenbol, M. W., "Changes to existing contracts under the EU procurement rules and the drafting of review clauses to avoid the need for a new tender", *Public Procurement Law Review*, 2013, 2, pp. 51-52, use of "change", "modify", "adaptation" and "amendment" used in "introduction and purpose"; Kahn, S. G., "Unilateral modification clauses in long term contracts", *International Business Law Journal*, 1986, 2, p. 146, on contract clauses stating: "such clauses, variously termed "modification", "changes" or "variation" clauses deal predominantly with the subject matter of the contract..."; Miller, J. and Cohen, L., "One change too many! Is there any position for the American concepts of "cardinal changes" and the "cumulative impact doctrine in English law?", *Construction Law Journal*, 2002, 18(5), pp. 382-383, on variations using the words "variation", "alteration" "changes" and "modification" whilst making the point that the American concept of "variations" appears wider than the UK position;

There is arguably a distinction between adjustments that are made pursuant to review clauses and therefore pursuant to the contract, and those which are not made pursuant to the contract. Review clauses are important from a procurement law perspective as it has been suggested that adjustments made pursuant to properly articulated review clauses are not variations or changes to the contract. Where at tender stage, and in the subsequent draft contract, review clauses are included which take into account the possibility of adjustments then the implementation of these adjustments "will not be changes *of* the contract but changes *pursuant* to the contract".[25]

Specific review clause have been identified by the author for inclusion in this category of adjustments. These are namely: (i) change control clauses which define and provide a framework for changing contract terms and/or the scope of or nature of contract performance;[26] (ii) sub-contracting provisions;[27] and (iii) step-in provisions.[28]

Adjustments: operation of law

The second category of adjustments are those made to contracts during their term as a consequence of an operation of law. For these purposes "operation of law" means an event which causes the nature or substance of the contractual relationship between the

[25] Hartlev, K. and Liljenbol M. W., "Changes to existing contracts under the EU public procurement rules and the drafting of review clauses to avoid the need for a new tender", *Public Procurement Law Review*, 2013, 2, p. 67;

[26] The extent to which the change control clause defines the adjustment and provides the applicable framework varies from case to case and this may impact on the degree of protection offered to contracting authorities from a challenge on the grounds that the adjustment is a material amendment which should have been subject to a new contract award, on this point see *ibid*.;

[27] Sub-contracting provisions are clauses which allow for the contractor to delegate performance of some or all of its contractual obligations to a third party, where generally the contractor remains liable for the performance of the contract *vis a vis* the contracting authority;

[28] Step-in provisions allow for the performance of some or all of the contract by either the contracting authority or in cases where external funding is provided, such as in the context of private finance initiative (PFI) by funders or a third party appointed by the funders. Whilst and to the extent the contract is subject to step-in, the contractor is not typically responsible for contract performance and would resume responsibility once the required action had been taken and the entity had "stepped-out" of the contract.

contracting authority and the contractor to change as a consequence of that event rather than at the instigation of either party.

The author has identified the following scenarios which can be categorised as operation of law which may, where they occur during the term of a contract, be considered to be adjustments.[29] These are (i) insolvency;[30] (ii) change in control; (iii) assignment; (iv) step-in; (v) change in law; and (vi) force majeure.

Adjustments required or occurring as a consequence of an operation of law may be distinguished from those adjustments made pursuant to review clauses, as they were not in the express contemplation of the contracting authority and the contractor when the contract was competed and entered into. They can also arguably be distinguished from the final category of adjustment described below, as adjustments required or occurring as a consequence of an operation of law may take effect outside the control of the parties. These adjustments may have less negative impact on the principles of competition as they may have impacted all of the potential contractors equally.

[29] It should be noted that the contractor in certain factual circumstances may have control over whether or not the operation of law takes place. For example, a contractor would be unable to assign a public contract without intending to do so. However, once the assignment is effected it will operate at law independently of the parties. The distinction between operations of law that the contractor has a degree of control over and those that are outside its direct influence will be considered in detail in the study;

[30] Insolvency is a technical area. However, in case of insolvency the contractor will be unable to trade on its own account and its affairs will be conducted by an insolvency practitioner. The insolvency practitioner will take steps either to secure the continued viability of the contractor or to realise assets for distribution to the contractor's creditors. The insolvency practitioner is enabled through applicable legislation to take such steps. This is relevant to contract adjustments as there may be the substitution of the contractor for another entity, and adjustments may be required to the terms of the contract to allow for its continued performance. See on contract adjustments and insolvency, Comba, M., "Retendering or sale of contract in case of bankruptcy of the contractor? Different solutions in an EU comparative perspective", in Gustavo Piga and Steen Treumer (eds), *The Applied Law and Economics of Public Procurement: the economics of legal relationships*, Routledge, 2013, pp. 201-211 and Treumer, S., "Transfer of contracts covered by the EU public procurement rules after insolvency", *Public Procurement Law Review*, 2014, 1, pp. 21-31;

Adjustments: others

This category includes adjustments which are made other than pursuant to review clauses and other than as a consequence of an operation of law. This is an important category as such adjustments may be required to ensure the continued performance of the contract to deliver the services that are required by the contracting authority.[31]

This may be the case where an unforeseen event requires the scope of services delivered to require adjustment or it may be the case that developments (such as a change in the demands of service users or the introduction of new technology) make adjustments desirable.[32] However, it is also possible that adjustments may be undertaken to intentionally prefer a specific contractor or to intentionally avoid the requirement to run a competition.

The adjustments which are considered in this category are (i) adjustments made to the scope of services performed under the contract; (ii) adjustments to other contractual terms, such as those which affect the risk profile of the contract such as insurance levels and the removal of termination clauses; and (iii) adjustments to contractual terms relating to payment.

These adjustments can be distinguished from those made pursuant to review clauses, as they are not dealt with by way of review clauses and have not therefore been included within the scope of the competition for the public contract. They are also separate from the

[31] This point is acknowledged by the Advocate General in *Pressetext* at para 43: "It is above all the case of continuing obligations and contracts of long duration that it may become necessary during the currency thereof to adjust their contact if contractual provisions - for example, owing to unforeseen changes in external circumstances - prove no longer to be appropriate. Where a contract is brought in line with the altered circumstances, such adjustment may assist the attainment of the aim of the contract", Opinion of Advocate General Kokott delivered on 13 March 2008, Case C-454/06, *Pressetext Nachrichtenagentur GmbH*;

[32] Poulsen, S. T., "The possibilities of amending a public contract without a new competitive tendering procedure under EU law", *Public Procurement Law Review*, 2012, 5, pp. 167-187.

category of operation of law adjustments as, whilst in practice the contracting authority's ability to decide whether or not to proceed with the adjustment may be constrained by the applicable circumstances, the decision whether or not to make the adjustment is within their control (which may not be the case for adjustments within the above category).