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# UK Public Procurement Law Digest: Contract Extensions and the New Remedies Regime

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**Most people involved in UK public sector procurement will be aware by now of the new public procurement remedies regime which took effect on 20 December 2009. This Update examines the impact of the new remedies regime in situations where authorities are seeking to extend an existing public sector contract – and also provides a refresher on how to assess proposed contract extensions in terms of procurement challenge risk.**

The new remedies – especially that of mandatory set-aside – pose a greater threat to authorities extending existing contracts than to first-time contract awards. Using a case study of a typical contract extension situation, this Update also explains that the best way for an authority to reduce the risk of procurement challenge to a contract extension is, perversely, to alert the market (and potential challengers) to the proposed extension. Authorities will be torn between not wanting to alert the market but needing to do so in order to reduce risk of challenge. We think that this is known as a Catch 22.

## INTRODUCTION

The new remedies regime is generally accepted to be one of the most significant changes in public procurement over the past 5 years and one which may trigger significant changes in how contracting authorities, losing bidders and winning bidders behave in relation to public sector contracting processes. We have identified in a previous Update the main practical implications of the new remedies.[1]

However, in all the many thousands of words that have been written about the new remedies regime, the focus has been almost exclusively on the impact of the regime on new procurements and contract awards. Almost nothing has been written about the effect of the new remedies regime on a very large sector of the procurement market – that is, extensions to existing public sector contracts. This Update analyses the intersection of the new remedies regime with one of the other main changes in public procurement law over the past few years – that is, the European Court of Justice decision in the *Pressetext* case which is generally considered to have a profound impact on the way in which authorities go about negotiating and implementing changes to existing public sector contracts.

## A CASE STUDY

To understand the impact of the remedies regime on contract extensions, it may be helpful to consider a typical situation that frequently occurs. Imagine that a particular Department has entered into an IT services contract with a Supplier.

[1] See our January 2010 update "New Public Procurement Remedies in the UK"

 

The contract was entered into following an openly advertised competitive dialogue procedure in which the Supplier won out over two losing bidders.

Three years later, the Department wants to make a significant number of changes to the contract but does not want to go back out to the market; it simply wants to re-negotiate and make changes to the existing contract with the Supplier. The changes include:

- some new types of services not previously covered by the contract (but which arguably could have been within the scope of the original OJEU notice);
- an extension to the term from 5 years to 7 years; and
- a re-negotiation of some of the commercial terms of the contract, for example to reduce some service levels but raise others, defer some of the benchmarking provisions, change the way indexation works, and reduce prices in the near term in exchange for an increase in the price in the extended years.

How exposed is the Department to the risk of procurement challenge and the risk of a remedy under the new regime as a result of what it intends to do? What should it do to justify the proposed re-negotiation? Does it risk cancellation of the amended contract (or other remedies) if it proceeds?

## VARIATIONS OR EXTENSIONS TO EXISTING CONTRACTS

We have previously written a separate Update about the impact of the European Court of Justice case in *Pressetext* and the rule which it set out in relation to proposed amendments or variations to existing public sector contracts.[2] The rule is that any “material difference” to an existing procured contract should be subject to a new procurement process and should not simply be agreed to with the incumbent. The key part of the ECJ's ruling in *Pressetext* is that a change to an existing contract would constitute a “material difference” where:

- the change to be introduced into the contract conditions, had it been part of the initial tender, “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”; or
- the change would result in the scope of the original contract being extended “considerably to encompass services not initially covered”; or
- the change would result in a shift in “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.”

The first two of these tests are simply reiteration of two existing well-known tests, but the third test – relating to the shift in economic balance – introduces a new way of determining when an amendment to an existing public procurement contract ought to be subject to a new, openly advertised award procedure and when an existing contract could simply be amended by re-negotiation with the incumbent without requiring a brand new procurement.

In our case study, how should the Department react to the *Pressetext* principles given what it intends to do to its contract with the Supplier?

[2] See our January 2009 update “Amending an Existing Contract”

 

## SERVICES

1. With regards to the planned new services, the Department should first check whether they were in-scope of the original advertised procurement. If they were, but they were simply not originally contracted for, it will feel comfortable that it is not falling foul of the first or second *Pressetext* tests. This is clearly the safest basis to proceed with a re-negotiation as to services.

2. If the services were not originally in-scope, the Department may still not be completely blocked. The Department will look to some of the exemptions contained within the Public Contracts Regulations 2006 ("PCR") to see whether any apply. Some of these exemptions are absolute (*e.g.*, certain types of financial services or R&D services fall outside the requirement to follow open procurement) whereas others are more limited.

3. Regulation 14 of the PCR sets out a number of circumstances when the Department could proceed down a negotiated procedure route to add services without open advertising. These include: when, for technical or artistic reasons, or for reasons connected with the protection of exclusive rights, the public contract may be awarded only to a particular economic operator; if, for reasons of extreme urgency brought about by unforeseeable events, the time limits specified for the open, restricted or negotiated procedures cannot be met; or if the Department wants the Supplier to provide additional services which have become necessary, and such services cannot for technical or economic reasons be carried out or provided separately from those under the original contract without major inconvenience.

4. The Regulation 14 partial exemptions do provide some latitude to the Department to add services even if the contract didn't originally cover them. But, of course, the more the Department pushes the boundaries and relies on wide interpretations of Regulation 14, the more the spectre of the new remedies regime looms.

## TERM

5. As with service extensions, the key question with a term extension is whether the extended term was within the bounds of what was originally told to the market. If it was, then a term extension ought to be acceptable under the first test in *Pressetext*, although one cannot rule out a problem under the third test. Unlike services extensions, the scope for partial exemption under Regulation 14 is much more limited.

## OTHER CHANGES

6. The other changes that the Department proposes involve the new, third test of *Pressetext*. But the third test – relating to the shift in economic balance – potentially covers new ground and raises the possibility that contract changes previously regarded as being entirely within the ordinary course of dealings in the contract management phase might now be prohibited. The Department must be on its guard to ensure that significant contract changes are not made to the existing contract without first checking whether the proposed change is so material that it is impermissible, and in fact would require a new procurement process.

7. In practice, the Department will need to conduct an exercise with its commercial team and any external advisers to determine whether the changes that are planned to be made to the contract would result in a shift of the economic balance of the contract in favour of the Supplier in a manner which was not originally provided. This task is rarely as straightforward as it seems.

8. One of the issues which is as yet unclear in the case law is whether the planned changes need to be considered individually in order to determine their effect on the economic balance or whether it is appropriate to take a high-level view of the whole series of changes. The ECJ in *Pressetext* considered the changes individually, although this was a feature of how the Court was asked a series of individual questions. In our experience, most authorities are taking the latter view and are conducting a review of the series of changes to determine the <u>overall</u> balance and, in most cases, ensuring that the net effect is either positive to the authority or, at worst, neutral. It is helpful that in the *Pressetext* case the European Court of Justice ruled that changes which are detrimental to the Supplier are not affected by the case and are not required to go through a new procurement exercise. Obviously, if the review by the Department concludes that the overall balance of the changes when taken as a whole are favourable to the Supplier, then the rule would be that a new procurement exercise would need to be conducted.

Of course, the danger for the Department is that it doesn't know for sure whether it has taken the correct approach or reached the right conclusion. It cannot rule out that an aggrieved losing bidder might become aware of the extension and take a different view - *i.e.*, by alleging that the extension does have a net overall effect on the economic balance of the contract and ought to have been opened up to tender. In those circumstances, the new procurement remedies regime provides greater scope for aggrieved bidders or potential bidders to apply for remedies against the Department, one of which would involve a mandatory setting aside of the extension.

Accordingly, the review by the Department can certainly help to assess or mitigate the risk of challenge and adverse remedies but it cannot entirely eliminate the chance that an aggrieved bidder might take a different view and might make an application under the procurement remedies regime.

## PROCUREMENT REMEDIES REGIME

So, assuming the Department goes ahead with the extension, what would be the position under the new remedies regime?

1. Firstly, assuming that an aggrieved bidder finds out about the extension and wishes to challenge, unless the bidder finds out before the extension is signed, then the most likely remedy is to apply for damages against the contracting authority. The exposure to damages under the remedies regime is unlimited but it must be a mitigating factor in terms of the risk to the authority that the damages themselves would have to be scaled back according to the probability of the losing bidder actually winning had the new set of services or the amended contract been advertised.

2. If an aggrieved bidder finds out about the extension before it is signed, it may apply for an injunction to prevent the extension going ahead. Under the new rules, the first effect of an application for a remedy at this stage would be to cause a mandatory suspension of the proposed extension. The onus would be on the Department to apply to the court to overturn the

 

suspension and allow it to proceed with the project.

3. While a complainant has to do relatively little to cause a mandatory suspension of the proposed contract award/extension (*i.e*., merely issue and serve legal proceedings), the bar is set higher for success on an injunction applications. The well-known case of *American Cyanamid v Ethicon* in 1975 laid out the tests that the complainant must show a serious issue to be tried, that damages must be an inadequate remedy, and that the balance of convenience must favour the granting of the injunction.[3]

4. Most of the published cases on both injunction hearings and applications for damages concern initial contract awards where there has been a technical breach of procedure, say in relation to the application of selection or award criteria. The issues often come down to ones of subjective interpretation of the rules. The problem for the Department in our case study is that the issues are likely to be more clear-cut – that is, it has simply not advertised the proposed extension in the first place, so the prospect is greater of a court determining that there is a serious issue to be tried and that the balance of convenience favours the injunction.

5. So the Department has to fear a mandatory suspension under the new rules and a possible injunction application if – perhaps a big "if" – an aggrieved bidder manages to find out about the Department's plans and apply before the extension contract is signed. On top of this, of course, one has to add the threat of the new mandatory remedy of set-aside/ineffectiveness, which can hang over the Department for up to 6 months after the extension contract is signed.

6. One of the grounds on which mandatory set aside is a required remedy is where an award of contract was made without prior advertisement, despite the requirement for prior advertisement. Obviously, in this extension situation, that would be exactly what would have happened – *i.e*., the current extension ought to have been treated as a new contract (because none of the exemptions applied) and ought to have been advertised. Therefore, as long as the challenging bidder is able to establish that an advertisement ought to have been made but wasn't, then the mandatory set aside remedy becomes available.

7. This is why position in relation to extensions of contracts is arguably worse than in relation to new contracts, because at least in relation to a new contract in most cases an advertisement will have been made, thus eliminating the "easiest" ground for the mandatory set-aside remedy. In relation to new contract awards, the only likely ground for ineffectiveness requires the complainant to show that there has been a breach of one of the main procurement provisions and a breach of standstill and the combination of the breaches must have been such as to affect the chances of the bidder winning the contract. In relation to extensions, it almost becomes axiomatic that one of the key grounds for the mandatory set aside will not have been fulfilled and therefore the set-aside remedy becomes available. The risk of mandatory set-aside applications is therefore greater in relation to extensions than in relation to first time contract awards.

[3] Two recent cases demonstrate the application of these tests in the procurement sphere: *European Dynamics v HM Treasury* (2009) and *B2Net v HM Treasury* (2010)

 

## MITIGATING THE RISK

So what can the Department do if it feels there is some risk of enhanced remedies in relation to a proposed extension of contract?

1. One glimmer of light exists in relation to the time limits for bringing a claim under the new remedies regime. The general rule for aggrieved bidders seeking formally to challenge is that the claim must be made promptly and in any event within 3 months beginning with the date when the grounds for starting the proceedings first arose.[4] However in relation to set-aside, the rule is that the bidder has 6 months to bring legal proceedings. This means that the Sword of Damocles would be hanging over the contract extension for up to 6 months after the time when it is done. This 6-month limitation period is subject to an exception that the time for applying for set-aside is reduced to 30 days if the Department either publishes a contract award notice in the Official Journal or serves the losing bidders a secondary or voluntary award notice explaining the proposed extension and the reasons for it.

2. The problem in relation to extensions, of course, is that if one of the requirements is to serve a summary notice on losing bidders, it is very difficult to know who the losing bidders would be and on whom the summary notice ought to be served. It might be possible to go back to the original losing bidders from the original contract a few years ago. But these may have changed or there may be other bidders who would have been interested had the requirement to advertise been fulfilled in relation to the extension.

3. Another approach that the Department might take is to publish a “voluntary transparency notice” in the Official Journal and wait 10 days after the publication of the voluntary transparency notice before entering into the extension contract.[5] By doing so, the Department would go to the heart of the first ground for ineffectiveness and remove it as a basis of claim.

4. Of course, filing the voluntary transparency notice increases the chances of an aggrieved bidder applying for an injunction and triggering a mandatory suspension. As a result, the Department may consider that alerting the market in this manner to be a risky strategy, but if the real aim is to de-risk the extension then filing a voluntary transparency notice may be seen as a small price to pay in the short-term for longer-term peace of mind. The alternative is to do nothing externally, sign the contract extension and then either keep fingers crossed for 6 months or agree to some form of 6-month lead-time or extended transition on the extended contract.

5. If one looks at this situation from the perspective of the Supplier with which the Department is proposing to conclude an extension, the Supplier is likely to want to require the Department to follow a de-risking strategy because it doesn’t want to begin work on an extended contract and then have it taken away.

[4] See our recent update “Limitation Period and the Need for Promptness” for the interpretation of the “promptly” requirement.
[5] Regulation 47K

6. It also means that incumbent suppliers will be far more likely to want to negotiate into the terms of contract extensions some provisions for unwinding or seeking compensation in the event that there is a successful application to set aside and the winning bidder suddenly finds that it has "lost" the extension that it thought it had gained. The types of contract provisions which might be considered could include warranties or indemnities from the authority – although the authority is likely to want to share the risk. The parties could consider discussing an alternative form of modification or extension as a back-up; and certainly would want a strong severability clause to make sure that, in the event of a suspension or set-aside, the pre-extension contract could continue despite a declaration of ineffectiveness.

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