



Procurement Policy Note – preliminary guidance on the application of the public procurement rules to development agreements.

Information Note 11/09 16 October 2009

Issue

1. This note discusses the applicability of the public procurement rules¹ to “development agreements” between local authorities or other public bodies and developers. It sets out some of the circumstances which may reduce or increase the likelihood that a development agreement will be subject to the public procurement rules. OGC understands that this issue is currently of concern to a number of local authorities and others, particularly in the context of European Court of Justice cases, for example Case C-220 / 05 - Jean Auroux and others v Commune of Roanne (the Auroux case).

Dissemination

2. Please circulate this Procurement Policy Note (PPN) within your organisation, agencies, non-departmental public bodies (NDPBs), and any other bodies for which you are responsible for, drawing particular attention to those with a purchasing role.

Contact

3. Enquiries about this paper should be addressed to the OGC Service Desk 0845 000 4999 servicedesk@ogc.gsi.gov.uk.

Introduction

4. This note is being issued at this time following requests from stakeholders, but it is not intended to be definitive or comprehensive; in particular our assessment may develop depending on future feedback from the European Commission. Therefore if it is appropriate OGC will issue additional guidance in future. This guidance has been developed in consultation with Communities and Local Government.

¹ Reference to the “public procurement rules” or “the rules” is intended to mean the European directives governing public procurement (in particular 2004/18/EC and predecessor directives), the UK regulations implementing these directives, and applicable European Court of Justice and national case law)

5. There is a summary of key points at the end of the note.
6. It is emphasised that the European authorities are likely to take a view of the intent and purpose of activities and agreements entered into by a public body, and artificial arrangements intended to circumvent the application of the rules are unlikely to be persuasive. Public bodies should proceed with that in mind, and they are strongly recommended to seek their own case-specific legal advice before entering into agreements.

Background

Development agreements and public procurement

7. The European Commission has raised concerns that a number of “development agreements” which have been or may potentially be entered into, in the UK between public bodies and developers may have the characteristics of public works or public works concession contracts, and should therefore have been procured in accordance with the public procurement rules. In many of those cases the UK has argued in response that on the particular facts the public procurement rules do not apply. However, although the Commission has very recently expressed its views on some of these cases, as yet we do not have the Commission’s decisions on all. **Therefore OGC’s understanding is subject to change depending on future arguments from the Commission.** At present we do not have a specific timescale by which we expect to hear the Commission’s views (or the result of potentially relevant ECJ cases) although it is likely that we will learn more later in 2009 or early 2010.
8. OGC knows of no formal single definition of a development agreement, and the detailed circumstances and arrangements of each case are likely to be different. At its widest it can mean any agreement between a contracting authority and a third party about the use or development of land or property. Typically such agreements are between a local authority and a developer concerning either a greenfield site or regeneration of a brownfield area. Often, but not always, the same authority will have statutory planning responsibilities for the area.
9. The focus of this guidance is to address issues which can arise in relation to development agreements following the Auroux case. OGC is aware that local authorities enter into planning agreements under section 106 of the Town and Country Planning Act 1990 or into agreements in connection with the exercise of compulsory purchase powers. The question of whether there is a public works contract or public works concession contract in these situations requires careful analysis. Certain recent infraction cases involve the potential applicability of the public procurement rules to section 106 planning agreements. OGC intends to publish a further paper on this subject in due course, depending on further clarification of the issues arising from the current relevant cases.

² Put briefly “delegated compliance” occurs where a developer itself undertakes the award-of-contract procedures under a mandate from the contracting authority, instead of the contracting authority directly undertaking the procurement. See paragraph 100 of the “La Scala” judgement.

Determining whether the public procurement rules apply to a development agreement

10. The applicability or otherwise of the public procurement rules to development agreements will depend on the particular facts of each case, and therefore universal guidance is not feasible. However, there are a number of matters which will be relevant in deciding whether a “development agreement” comprises a public works or works concession contract. In summary:
 - Is there a work or works required or specified by a contracting authority?
 - Is there an enforceable obligation (in writing) on a contractor to carry out that work or works?
 - Is there some pecuniary interest for carrying out this work (not necessarily a cash payment)?
11. If the answer to all those questions is “yes”, it is likely that agreement will be subject to the public procurement rules.
12. In addition, where any of the above apply, and the authority is granted the right to exploit the work or works under a development agreement, consideration should be given to whether a public works concession contract arises.
13. Some of these issues are considered in more detail below.

The Auroux case

14. This case concerned an agreement between the municipality of Roanne and a semi-public company SEDL, whereby the latter would undertake certain works, some of which would be put to public use and others would be sold to third parties.
15. The operative part of the ECJ judgement made clear that:
 - A contracting authority does not necessarily have to become the eventual owner of a work for the contract to comprise a public works contract;
 - For the purposes of deciding whether a contract exceeds the works threshold, the total value from the point of view of the tenderer is the relevant figure, including any sums to be received from third parties;
 - The fact that both parties to an agreement are contracting authorities, and the second authority will procure any consequent contract to physically carry out the work in accordance with the public procurement rules, will not exempt the original agreement from the rules.
16. The circumstances of this case were that:
 - The municipality of Roanne was the instigator and author of the project;
 - Part of the works were intended to meet the specific needs of the municipality;

- Those parts of the works not intended to be transferred to the municipality were nevertheless part of the specified requirement;
- The municipality was to make a direct payment to SEDL for delivery of part of the works;
- The municipality was to make a contribution to the funding of the rest of the development, and guarantees to SEDL. In the event that there was a profit on the closing balance sheet of the development this would pass to the municipality; and
- It also appears that the agreement between Roanne and SEDL placed contractual obligations on SEDL to undertake the development activities.

17. On those facts, in OGC's view there seems little reason to doubt that this should comprise a public contract, notwithstanding that part of the development was intended to be disposed of to third parties. Therefore the ECJ's judgement on that point does not, in OGC's view, provide a particularly contentious or surprising outcome.

18. Regarding the other points in the Court's judgement:

- i. That the total value should be seen from the point of view of a supplier appears to be consistent with the underlying purpose of the public procurement rules, bearing in mind that the agreement as a whole comprised a public works contract. (Note in OGC's view this does not necessarily mean that all developments containing both public contracts and private sector works will be required to be aggregated to assess the total value. This will depend on whether the two aspects are genuinely separable. This is discussed in more detail below).
- ii. That an obligation to advertise consequent contracts does not exempt an original contract from the rules, is consistent with OGC's understanding of the rules. OGC understands that in some cases public bodies have undertaken a "delegated tendering"² approach following the judgement in "La Scala" (Case C-399/98). However, the circumstances of each case must be considered carefully and a contracting authority cannot circumvent an obligation to adhere to the public procurement rules simply because its chosen contractor is itself also obliged to competitively procure relevant contracts in accordance with the public procurement rules.

19. Therefore OGC does not see the ECJ judgement in Auroux as fundamentally changing the applicability of the public procurement rules to development agreements. However, it has raised awareness of the issues with stakeholders.

Definition of "Specified requirement"

20. Importantly for the application of the public procurement rules in the current context, a public works contract is defined as a contract "for the carrying out of a work or works for the contracting authority or... to procure... the carrying out for the contracting authority of a work corresponding to specified requirements" (Regulation

2 of the Public Contracts Regulations 2006). As such the nature of the work in question has to be that required by the contracting authority.

21. In connection with that definition, OGC knows of no explicit guidance from the courts or the Commission as to how detailed a specification has to be; however it is clear that it does not have to be exhaustively detailed or be a full “technical specification” within the meaning contained in the Directive. We understand that in order to meet the definition, specifications have to be sufficiently specific and detailed, and have to be expressly referred to in the contract itself, such that they can be legally enforceable. The same principle is likely to hold with development agreements. Nevertheless, it is implicit that the requirements have to be those of the contracting authority (i.e. the contracting authority has decided “what it wants”), even if the particular means of achieving those requirements is to be decided at a later point. Moreover those requirements need to be set out with sufficient clarity and precision in a contract notice or other subsequent documents for economic operators to make an informed decision about whether or not to express an interest in meeting those requirements.
22. OGC would argue that the setting of broad parameters for a development is qualitatively different from the type of specification necessary to comply with the requirements of the public procurement rules.
23. A broad invitation, for example that a site should be developed in accordance with applicable national or local land-use planning policies for the land in question, but with the developer free to put forward its own intentions, proposals and specifications within those parameters, is unlikely in OGC’s view, to offer an adequate degree of precision to readily fall within the definition of a requirement specified by the contracting authority.
24. OGC therefore understands that where a contracting authority invites a developer or developers to submit their own proposals for the use or development of land or buildings, (competitively or otherwise) but without itself specifying the requirement, the public procurement rules may not apply, even if the contracting authority chooses the “winning” proposal (according to broad criteria pre-determined by the authority). In one particular case a Council invited developers to submit proposals to lease and develop a publicly owned building, and the Council expected such proposals to be consistent with the building’s “listed” status and with the local land use plans. The Council selected what it judged the most suitable proposal against a list of criteria advised to the developers. The Council agreed a long lease of the building, accompanied by a “development agreement” intended to safeguard the Council’s interests as freeholder. The specific function of the building and any works that had to be carried out were at no time specified by the Council. The conversion and use of the building was proposed by the developer and any works to convert the building to its own use will take place according to the developer’s design and specification, not to the Councils, as reflected in the agreement. It is unlikely that this comprised a public work or works concession to the specification of the authority, and thus was not subject to the public procurement rules.

25. Nevertheless, contracting authorities should take care to avoid a situation where a general invitation becomes or turns into a requirement to the authority's specification. Moreover a requirement derived from the land-use planning regime would not be exempt from the application of the public procurement rules simply by virtue of its basis in a planning requirement, if it did in fact have the characteristics of a public contract.

Transfer of land or property and the public procurement rules

26. The acquisition of land or existing buildings, or rights in or over land, by a public body is explicitly excluded from the scope of the public procurement rules (Regulation 6 (2) (e) of the Public Contract Regulations 2006. Moreover, the sale or lease of land or property by a public body is not within the scope of the public procurement rules, so a simple disposal of land is not caught as there is no acquisition (and thus no procurement) of any goods, works or services. Therefore the lease or sale of land by a contracting authority to a developer for the purposes of a development will not be subject to the public procurement rules unless this lease or sale contains or is accompanied by a requirement to undertake a work or works as defined in the rules.

27. Furthermore, in case C-331/92 "Gestion Hotelera" the ECJ ruled that "a mixed contract relating both to the performance of works and to the assignment of property does not fall within the scope of Council Directive 71/305/ EEC of 26 July 1971... (since succeeded by other Directives) if the performance of the work is merely incidental to the assignment of property". As far as OGC is aware, there is no explicit definition of what would be considered incidental or ancillary (a recent ECJ ruling indicates this will depend on the actual facts and circumstances of the case), but a conservative and purposive approach would be prudent. So, for example, the works would probably not be subject to the rules if scope and value of the works is small compared to the value of the sale, and would not have been pursued if the land was not being sold, and if the main purpose of the sale was not to achieve those works. On the other hand the works would be unlikely to be "incidental" if they involved a wide range of works or a lengthy programme of works activity.

28. From its decision in the case of "Flensburg" (see link below) it is clear that the Commission is of the view that a public works (or works concession) contract only arises if there is a specific legally binding contractual obligation to undertake the work or works. A sale or lease of land to a developer with the intention of both parties that the developer will undertake a particular work or works in accordance with the contracting authority's needs is not in itself sufficient to engage the public procurement rules. This is so even if the contracting authority has a contractual right to reacquire the land if the work is not undertaken.

29. <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/867&format=HTML&aged=0&language>

30. The Commission's decision to close the "Flensburg" case does not constitute a formal statement of Community law but it indicates the Commission's view as to whether a particular set of circumstances is outside the public procurement rules.

31. It is therefore OGC's view that a "development agreement" between a contracting authority and a developer which sets out the intended nature of the proposed development, is unlikely to constitute a contract subject to the public procurement rules unless the developer is placed under a binding obligation to carry out at least part of the development.
32. Further, if the developer is contractually entitled to decide unilaterally to promote a different usage of its own proposing (subject to planning consent), to delay the development, or to transfer the land in question to a third party, without breaching a contractual obligation, it is unlikely that the agreement will constitute a public contract subject to the public procurement rules.
33. Of course, as noted below, the Commission is likely to take a purposive view of all the relevant agreements between the authority and the developer. Thus hiving-off a contractual obligation to carry out a development into a separate agreement from the land transfer would not defeat the application of the rules.

Development agreement ancillary to a lease

34. OGC considers that a development agreement which accompanies a lease might not be subject to the public procurement rules. Where a contracting authority leases land or property to a developer, to be developed according to the intentions of the developer (and not to any specified requirements of the authority), that lease is not of itself a public contract. The payment of rent to the authority by the developer, (who in turn may collect rents from sub-tenants), is unlikely to comprise pecuniary interest for the supply of goods, works, or services. So if that development agreement only sets out certain matters and obligations as to how the developer will undertake its intention as lessee, in order to safeguard the interests of the authority as lessor and freeholder that agreement does not thereby become subject to the public procurement rules.

Building licences

35. OGC understands that on occasion, as an alternative to a development agreement, public authorities enter into a building lease or building licence with the purchaser/ developer for the duration of the construction period. This provides a means for the public authority to retain the freehold of the site (and ultimate control) to ensure that the purchaser's construction activities comply with specific land obligations. Once the developer has demonstrated compliance, the freehold is transferred.
36. The applicability or otherwise of the public procurement rules in such cases may depend on the specific circumstances. However, if the purpose of the licence is to ensure that the purchaser does not go back on its own intended activities a licence probably does not of itself to give rise to a contract subject to the public procurement rules (although adopting the use of building licence in an attempt to avoid application of the public procurement rules would not succeed).

Mixed Land Ownership

37. Where a proposed or intended development includes a mixture of land or property owned by the authority and land owned by a developer or third party, the potential application of the public procurement rules may depend on the specifics of the proposed arrangement. If the authority simply intends to sell or lease land or property to the developer to be incorporated into the latter's intended development that is also unlikely of itself to give rise to obligations under the public procurement rules unless that sale/lease also imposes works obligations on the developer.
38. Where part of the activity within an overall development is likely to have the characteristics of a public contract, the authority may wish to consider competitively letting a separate contract or series of contracts for those elements of the development, distinct from any development agreement for the rest of the development (see below).

Developments potentially including a public contract

39. On occasion a public body may wish to enter into a development which itself is unlikely to be subject to the rules (as it falls within some of the circumstances set out above) but where the authority also has associated requirement(s) which may comprise a public procurement. For example, an authority may wish to lease property to a developer, to be developed according to the developer's proposals, but where the property in question currently includes a building occupied or used by the authority. The authority may therefore have a requirement that a replacement facility is provided, perhaps elsewhere.
40. It is likely that the work for the replacement facility would comprise a public works contract if it is work to be done to the authority's required specification, with a contractual obligation to construct it, and for some form of consideration. It would therefore be potentially subject to the public procurement rules. Public bodies are therefore recommended to pursue the construction of such a requirement as a separately-procured activity from the intended land transfer and associated development agreement. On the other hand, if the specific circumstances make it impracticable to achieve such a separation and the works to the authority's requirement are contractually and operationally inseparable from the rest of the project, there are likely to be doubts as to whether the agreement(s) as a whole will fall outside the public procurement rules.
41. A similar case might arise where an authority intends to sell land to a developer for housing but retains a continuing interest in the development of the site because the authority is to be entitled to allocate tenants to a proportion of the housing. If the developer is placed under an obligation to undertake the works to an agreed specification, the agreement may comprise a public works or public works concession contract, even if the specification was arrived at with the assistance of the developer.

Summary

42. Based on its understanding of current relevant case-law and the Commission's decisions, OGC suggests that a "development agreement" between a public body and a developer may be less likely to comprise a public works or works concession contract, if it meets some of the following characteristics:
- i. The proposed development (or a significant part) is to be undertaken at the initiative and autonomous intention of the developer. (This may be particularly likely if the developer already owns or has control of land to be developed);
 - ii. The development agreement is ancillary or incidental to a transfer or lease of land or property from the authority to the developer, and is intended to protect the interests of a contracting authority which is the lessor or otherwise retains an interest in the land or property;
 - iii. The development agreement is based on proposals put forward by the developer, rather than requirements specified by the contracting authority, albeit that these proposals may be sought, and the "winner" chosen by the authority;
 - iv. There is no pecuniary interest passing from the contracting authority to the developer as consideration for undertaking the development, either through direct payment, or indirectly, for example, by the assumption of obligations such as contributions towards project finance or guarantees against possible losses by the developer;
 - v. The development agreement does not include specific contractually enforceable obligations on the developer to realise a work or works, (even if that work or works is recognised as being the general intent of the parties to the agreement).
43. Where a development agreement falls outside some or many of these parameters there may be a greater likelihood that the agreement has the characteristics of a public works or public works concession contract.
44. The European Commission (and the ECJ) can be expected to look at the totality and overall nature of the relevant agreements between a contracting authority and an economic operator in relation to a development, to decide whether the public procurement rules apply. Any artificial arrangements intended to circumvent the application of the public procurement rules are therefore likely to attract challenge.
45. Of course, the facts of each intended development and the precise relationship between the parties are likely to be different at least in detail in each case, and generic guidance must be applied in the light of the specific circumstances. Public bodies are therefore strongly recommended to obtain their own legal advice before proceeding.

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