FTB PUBLIC PROCUREMENT LAW UPDATE

SECTION 106 AGREEMENTS AND PUBLIC PROCUREMENT: GOOD BYE *AUROUX*, WELCOME *MÜLLER*

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Introduction

1. Are s.106 agreements public works contracts for the purposes of the public procurement regulations? They clearly meet some of the standard criteria for a public contract: they are written, legally binding agreements between a local authority and a developer (and because they are a form of land charge they also bind successors in title.[1] In addition, their subject matter is occasionally the execution of some work, or 'the realisation, by whatever means, of a work corresponding to the requirements specified by the contracting authority'. Although no money changes hands from the Council to the landowner, it is obvious that in most cases the granting of a planning permission is of great monetary value to the applicant.

2. Nevertheless, in the case of s.106 agreements, the Council is not procuring works. It is merely exercising its powers of development control. It is not offering a contract but responding to an application. Moreover, the value realised by the developer is not strictly speaking something that passes from the Council to the developer (i.e. the Council is not paying for a service, namely the construction of public works). In fact, the Council does not pay the developer in any sense. The value is created by the development itself because and to the extent that it complies with planning law and policy. It is hard to see how such an agreement is for 'pecuniary interest' (as required by Article 1(a) of Directive 2004/18).

3. The differences arise because of the particular role of s.106 agreements as a flexible tool for the pursuit and enforcement of planning policy. Under the relevant ODPM

[1] Section 106 of the Town and Country Planning Act 1990 allows a local planning authority (LPA) to enter into a legally-binding agreement or planning obligation with a landowner in association with the granting of planning permission. The obligation is termed a Section 106 Agreement. These agreements are a way of delivering or addressing matters that are necessary to make a development acceptable in planning terms. They are increasingly used to support the provision of services and infrastructure, such as highways, recreational facilities, education, health and affordable housing. The scope of such agreements is laid out in the government's Circular 05/2005. A council's approach to securing benefits through the S106 process should be grounded in evidence-based policy.

Circular 05/2005 a s.106 agreement must be relevant to planning, necessary to make the proposed development acceptable in planning terms, directly related to the proposed development, fairly and reasonably related in scale and kind to the proposed development and reasonable in all other respects. It is apparent that these agreements are a flexible way of achieving the aims of planning policy. They are part of the regulatory powers of the Council. They are not a means of raising revenue.

4. Under the statutory framework of development control, planning agreements are 'material considerations' that may be used to make a proposed development accord with a development plan under s.38(6) of the Planning and Compulsory Purchase Act 2004. The relevant criteria are outlined by Lord Keith of Kinkel *in Tesco Stores Limited v Secretary of State for the Environment and Others* [1995] UKHL 22. Planning agreements are deployed to outweigh conflict with a given plan.

5. There is no direct case law on whether s.106 agreements are relevant public contracts under the public procurement Directives. Whether they fall under the public procurement Directive is a matter to be decided on the basis of general principles.

6. The aim of the public procurement rules it the facilitation of the free movement of services. The public procurement framework is based on a number of principles to be found in the Treaty including the principle of freedom to provide services, the principle of non-discrimination on grounds of nationality and the principle of transparency.

7. How do these general principles apply to s.106 agreements? The only directly relevant case on these questions is Case C-399/98 *Ordine degli Architetti v commune di Milano and Pirelli SpA*. This case involved an infrastructure contribution in kind provided for by Italian planning law. There are evident similarities with s.106 agreements although there are also evident differences. The most important difference was that the construction of the theatre at issue was in lieu of a pre-existing obligation to pay an infrastructure contribution.

8. Since the ECJ's judgment in *Auroux*, it has become clear that the procurement rules may apply to development agreements between local authorities and private parties.[2] *Auroux* was significant for establishing three propositions:

    a. a mixed contract, e.g. a contract involving both the disposal of land and the performance of works, will be a 'public works contract' depending on what is its 'main object'. The existence of a work must be determined 'in relation to the economic or technical function of the result of the works undertaken' (par. 41).

    b. It is immaterial whether the work will be owned by the Council or a third party.

    c. The value of the contract refers to the value of the contract to the developer, i.e. including revenue from third parties.

9. The cumulative effect of the three propositions alarmed Councils throughout the United Kingdom, because it meant that any s.106 agreement may have to be advertised according to the procurement rules. But the process would have bizarre

[2] Case C-220/05 *Auroux v Commune de Roanne* [2007] ECR I-385, [2007] All ER (EC) 918.

consequences: a developer may end up advertising for works in his land for the benefit of his competitors.

10. *Auroux* had a chilling effect. Several large urban regeneration projects were stopped for fear of violating the public procurement rules.

11. In addition, in June 2009 the Commission started proceedings against the United Kingdom over the award of a contract for development of land in the Osbaldwick area of York, complaining that the United Kingdom 'no measures have been introduced to ensure that the award of land development agreements will be compliant with the applicable EU rules'. So for a while there was great uncertainty about development agreements and councils.

12. Most of the worrying aspects of *Auroux* have now been reversed by *Müller,* [3] which I will discuss in detail below. Still, however, there may be circumstances where s.106 agreements may fall within the procurement rules.

13. Last May the Commission also decided to close the infringement proceedings against the United Kingdom. The Commission said that:

> After the Commission formally requested the United Kingdom to change the procedures followed (in the form of a "reasoned opinion" under EU infringement procedures … the UK authorities took the appropriate measures in order to reopen the contract to competition. This means that the project will not be realised on the basis of the original concession contract, but instead will be carried out in four distinct phases. The UK provided its commitment that the contract for each construction phase of the development will be awarded following a separate, open and transparent tendering process, in full compliance with EU law. In this way commercially attractive opportunities will be created for a wide range of potentially interested developers, with a positive impact on the region in terms of economic growth and employment.
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> In addition, the UK has put in place measures aimed at ensuring that these issues will not arise in future projects. To this end, it has published guidance on how public procurement rules apply to the award of concession contracts for land development. This gives the additional guarantee that in future, contracting authorities across the UK will comply with EU law in this area.

14. The reference to the UK's measures is to OGC's Procurement Policy Note on Development Agreements of 16 October 2009. This Policy Note does not explicitly cover s.106 agreements, but it provides very useful guidance, which now appears to enjoy official approval.

15. The OGC guidelines provide the following broad criteria:

> '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:

[3] Case C-451/08 *Helmut Müller GmbH v Bundesamt fur Immobilienaufgaben* ,CJEU (Third Chamber), 25 March 2010, nyr.

i. The proposed development (or 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;

ii. 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;

iii. There is no pecuniary interest passing form 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;

iv. 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).'

16. These guidelines are not intended to encompass s.106 agreements directly. According to this Notice, 'certain recent infraction proceedings [from the Commission] involve the potential applicability of the public procurement rules to section 106 planning agreements. OGC intents to publish a further paper on this subject in due course, depending on further clarification of the issues arising from the current relevant cases' (par. 9).

The *Müller* Judgment

17. This was a reference to the ECJ made in the context of proceedings between Helmut Müller GmbH ('Helmut Müller') and the Bundesanstalt für Immobilienaufgaben (the federal agency responsible for managing public property; 'the Bundesanstalt') concerning the sale by the latter of land on which the purchaser was subsequently to carry out works corresponding to the urban-planning objectives of a local authority, in the present case the municipality of Wildeshausen.

18. The case concerned what could have been a 'mixed contract', namely a contract of the sale of land coupled with an agreement for the particular development of it.

19. Helmut Müller brought an action before arguing that the sale of the land was subject to public procurement law as a mixed contract. The referring court asked a great number of questions.

20. The developer argued that the Council ought to have applied the public procurement regulations when (in the course of the exercise of its town and country planning powers) it indicated its preference for one project over another, when this preference

led a third party (the *Bundesanstalt*) to agree to sell the relevant land to the preferred developer. The peculiarity of this case is that there was no contract between the Council and the chosen developer, nor was there any planning permission yet granted. Nevertheless, the referring court (the Oberlandesgericht Düsseldorf) thought that there was a public works contract somewhere and that the procurement rules applied. It took the opportunity to ask a very wide range of questions arising out of *Auroux* and *La Scala*.

21. In response, the Advocate General proposed that 'for a given activity to fall within the ambit of the law on public works contracts there must *be a strong and direct link* between the public authority and the work or works to be executed'.

22. The Advocate General rejected the submission by the Commission that 'any increase in value of immovable property that is attributable to an activity of the public authorities should be subject to the provisions of the Directive', correctly identifying this position with the absurdity that any grant of planning permission would always be caught by the public procurement rules (par. 36). Instead, the Advocate General proposed that the 'scope of the Directive should be identified by reference, first, to the objective requirements specified in the Directive itself' (par. 39).

23. Following this general line of thought, the Advocate General suggested the following narrow reading of *Auroux*:

> 52. In my view, it is possible from a full examination of the measure, bearing in mind the meaning that the Court has so far attributed to it, to deduce the fundamental principle that for a given activity to fall within the ambit of the law on public works contracts there must be a strong and direct link between the public authority and the work or works to be executed. That link normally follows from the fact that the work or works are executed on the public authority's initiative.
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> 53. Contrary to the view taken by the referring court, non-material and indirect benefit alone is not sufficient. Nor is the mere fact that the activity to be assessed is, generally, in the public interest sufficient. It should be noted that, in cases where a permit for the activity has to be issued by a public authority (which is normally the case with all building activities), the activity must obviously be in the public interest in order to obtain a permit, since the public interest is the reference parameter on which the public authorities grant permission. Unless the scope of the Directive is extended indefinitely, the general existence of a public interest which justifies permission to pursue the activity cannot therefore constitute the decisive criterion for determining which cases are to fall within it. In particular, it must be borne in mind that a building permit, that is to say the typical expression of the authorities' powers in the *objective* area of town planning, is usually confined to removing restrictions on a private initiative, not a public initiative.

24. This argument has the consequence that the condition is met when, first, the public authority acquires ownership of the works produced and, second, 'the property to be produced is not procured by the public authority but is nevertheless of immediate economic benefit to that authority (par. 55). The condition is also met when, third, 'in cases where the public authority employs public resources for the execution of the work and/or works'(par. 55). It is also met, fourth, when the works 'are in any case the result of an initiative taken by the authority in question' (par. 59).

25. The Advocate General then adds this important qualification that is central to the question under discussion:

> 60. However, the third and last example calls for clarification in an important respect. The activity pursued by the public authority in that context must extend beyond mere exercise of the general powers vested in that authority with respect to town planning. That is the only way to draw a clear line between activities which fall within the scope of the Directive and 'normal' town planning activities which, as such, do not. To be precise, the type of activity pursued by the public authority in specific individual cases must be assessed by the national court on a case by case basis.
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> 61. Within that framework, the possibility cannot be ruled out that the realisation of a certain scheme for the development of land may be the subject of a contract that falls within the scope of the Directive. Such a possibility requires, however, that there be a direct link, in the sense indicated in the preceding paragraphs, between the public authority and the work or works to be carried out. The mere pursuit of the public interest through recourse to ordinary town planning powers is not sufficient cause to apply the Community rules on contracts and concessions.

26. It follows that for the Advocate General, the proper exercise of town and country planning powers would very rarely be caught by the public procurement directives.

27. The Court's judgment followed most of the Advocate General's advice. The Court cites the new German legislation of April 2009 according to which, a public works contract should be related to work 'which is of immediate economic benefit to the contracting authority'. The ECJ ended up following this solution, establishing the principle that public works contract must refer to a work of '*direct economic benefit to the contracting authority*'.

28. The precise formulation was as follows:

> 48. The pecuniary nature of the contract means that the contracting authority which has concluded a public works contract receives a service pursuant to that contract in return for consideration. That service consists in the realisation of works from which the contracting authority intends to benefit (see Case C-399/98 *Ordine degli Architetti and Others* [2001] ECR I-5409, paragraph 77, and Case C-220/05 *Auroux and Others* [2007] ECR I-385, paragraph 45).
> 49 Such a service, by its nature and in view of the scheme and objectives of Directive 2004/18, must be of direct economic benefit to the contracting authority.

29. The Court gives further detail. It outlines *three* different categories of cases.

30. In the first, the economic benefit is 'clearly established' because the public authority is becoming the owner of the works.

31. In the second, the economic benefit 'may be held to exist' when the public authority is to hold a legal right over the use of the works in order that they can be made available to the public.

32. In the third, the direct economic benefit may lie in the economic advantages which the contracting authority may derive from the future use or transfer of the work.

33. The court explains the application of the three categories as follows:

> 50 That economic benefit is clearly established where it is provided that the public authority is to become owner of the works or work which is the subject of the contract.
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> 51 Such an economic benefit may also be held to exist where it is provided that the contracting authority is to hold a legal right over the use of the works which are the subject of the contract, in order that they can be made available to the public (see, to that effect, *Ordine degli Architetti and Others*, paragraphs 67, 71 and 77).
> 52 The economic benefit may also lie in the economic advantages which the contracting authority may derive from the future use or transfer of the work, in the fact that it contributed financially to the realisation of the work, or in the assumption of the risks were the work to be an economic failure (see, to that effect, *Auroux and Others*, paragraphs 13, 17, 18 and 45).
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> 53 The Court has already held that an agreement by which a first contracting authority entrusts a second contracting authority with the execution of a work may constitute a public works contract, regardless of whether or not it is anticipated that the first contracting authority is, or will become, the owner of all or part of that work (*Auroux and Others*, paragraph 47).
> 54 It follows from the foregoing that the concept of 'public works contracts' within the meaning of Article 1(2)(b) of Directive 2004/18 requires that the works which are the subject of the contract be carried out for the contracting authority's immediate economic benefit; it is not, however, necessary that the service should take the form of the acquisition of a material or physical object.

34. The Court then discusses the issue of whether the condition is met when the contracting authority is acting as a development control body. It states that the exercise of planning function is not caught by public procurement:

> 55 The question arises as to whether those conditions are satisfied where the purpose of the intended works is to fulfil an objective in the public interest, the

> achievement of which is incumbent on the contracting authority, such as the development or coherent planning of part of an urban district.
> 56 In the Member States of the European Union, the execution of building projects, at least those of a certain size, is normally subject to prior authorisation by the public authority having urban-planning powers. That authority must assess, in the exercise of its regulatory powers, whether the execution of the works is in the public interest.
> 57 However, it is not the purpose of the mere exercise of urban-planning powers, intended to give effect to the public interest, to obtain a contractual service or immediate economic benefit for the contracting authority, as is required under Article 1(2)(a) of Directive 2004/18.

35. It follows that the mere exercise of 'regulatory urban planning powers' does not constitute public works contract. I shall call this '*the planning exception*' for the purposes of this presentation.

What does this mean for s.106 agreements?

36. What does the 'planning exception' mean for s.106 agreements? The language in the judgment is of an 'objective' 'direct economic benefit' to the contracting authority. When such a benefit exists, we have a public works contract. Ownership, other legal rights or other economic advantages are states of affairs that can be open to evidence.

37. Nevertheless, the planning exception seems to apply subjectively. Here we are introduced to the 'purpose of the intended works'. There may be cases where the public authority falls under one of the three cases identified in par. 50-52 of the judgment in the process of acting as a regulatory urban planning power.

38. Does paragraph 55 introduce a general exception for works contracted for such a purpose, namely the purpose of promoting town and country planning and development control? I shall call this the wide reading. The wide reading is supported by paragraph 57 of the judgment, where it is categorically stated that the exercise of planning powers is not intended to obtain 'immediate economic benefit':

    > 'However, it is not the purpose of the mere exercise of urban-planning powers, intended to give effect to the public interest, to obtain a contractual service or immediate economic benefit for the contracting authority, as is required under Article 1(2)(a) of Directive 2004/18'.

39. But there is the troubling word 'mere' here.

40. In some cases planning is combined with other things, including deriving economic benefits, as in s.106 agreements. So in this narrow reading, we have a fourth category of cases, where the public authority is exercising its powers meeting one of the objective criteria, namely a) owning the works, b) holding a legal right over the use of the work or c) deriving benefits from it, and it meets the subjective criterion of intending to give effect to planning considerations, but where the planning exception does not work. This new category of cases, would fall under the procurement regime.

This is what the word ‘mere’ would suggest. This would be a narrow reading of the planning exception. Some ‘mixed’ contracts would fall under the procurement regime.

41. We are not helped here by the fact that according to established case law, confirmed by *Auroux* in par. 37, where a contract contains elements relating both to public works contract and another type of public contract, it is the ‘main purpose’ of the contract which determines if the Directive on public contracts applies. So it all turns on ‘purposes’. Is the planning purpose the main purpose?

42. Here is our interpretive dilemma summarised. For the *wide* reading of the planning exception any element of planning purpose is enough to exclude a contract from the public procurement regime. For the *narrow* reading of the planning exception only when the planning purpose is the main purpose does the exception apply. Some planning contracts would still be covered. The answer to this question is not clear from the text of the judgment and it is clearly crucial to the fate of s.106 agreements.

43. The Advocate General also leaves the question relatively open. He is assuming that the exercise of urban-planning powers will not involve any direct benefit to the Council, but does not address the case where the two cases overlap.

44. Under the wide reading of the exception, all s.106 agreements are exempt from public procurement rules. That is, of course, if the agreement in question is a true planning agreement and does not go beyond what is allowed under the standard rules (summarised in Lord Keith’s judgment).

45. Under the narrow reading of the exception, we are to examine them on a case by case basis as ‘mixed contracts’.

The Requirement of Contractual Obligation

46. One further aspect of the *Muller* judgment is that it clarifies what has become known as the ‘Flensburg’ exception. The ECJ confirms that the condition of a public works contract is not met if there is no clear contractually binding obligation.

47. The ECJ stated: ‘The intentions revealed by the documents in the case-file do not constitute binding obligations and cannot in any way satisfy the requirement of a written contract which is inherent in the very concept of a public contract set out in Article 1(2)(a) of Directive 2004/18.’

48. In my view the judgment confirms the guidance explicitly endorsed by the OGC namely that: ‘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’

Three case studies – Assuming a Narrow Reading of the Exception

49. I shall now turn to three hypothetical cases that illustrate the application of the narrow reading of the ‘planning exception’.

50. *Case A: the developer agrees to construct a pre-school nursery.* Let us assume an agreement that provides that the Owner will enter into arrangements with a nursery operator on a standard commercial basis and that the nursery will have to comply with certain quality standards and, second, will have the nursery transferred to them if the owner reasonably showed that it could not operate it on a sound commercial basis. This meets, in my view, the second and third criterion of a 'direct economic benefit' to the contracting authority.

51. *Case B: Highway Works:* Let us assume that the agreement includes the building of works, such as a new roundabout or a road. Such works, assuming they are owned by the council also meet the first criterion of a 'direct economic benefit'.

52. *Case C. Affordable Housing*: Let us assume that the agreement provides for affordable housing units that are meant to cover 35% of the total permitted Residential Units comprised in the Development. They are to be made available to meet the needs of eligible households including availability at a cost low enough for local residents to be able to purchase them. . In my view, it is hard to consider this as something of a 'direct economic benefit' to the Council. There is certainly some benefit, but is this not the exercise of general planning policy? One can imagine, however, the ECJ and the Commission taking a different view.

53. *What is the cumulative effect for a single hypothetical s.106 Agreement providing for all three types of works?* The judgment will of course have to be made on a case by case basis. All three cases meet the subjective criterion of a planning purpose. The first and the second clearly meet the objective criterion of 'direct economic benefit'. Are they enough to characterise the whole s.106 agreement a 'public works contract'?

54. A lot will depend on the value of the development and the value of the contributions in kind. In my view all of these arrangements appear to be well within the appropriate scope of planning agreements under the relevant legislation and guidance. I would conclude that the main purpose of the Agreement was related to planning. These works were not commissioned by the Council. They were offered by the developer in order to overcome planning objections that would otherwise apply. In some ways this can be seen to be subject to the 'Flensburg' exception, in that these works are entirely parasitic on the development proposal. Strictly speaking they are contractual obligations, but they are not works commissioned by the Council in a contract for public works.

55. Nevertheless, the opposite view would also be possible. The Commission may take the view that some such planning agreements were really a public works contract, because its main purpose was not planning but the execution of works. We have no case law to go by. The York case, was on a different issue and cannot help us here.

56. If the given s.106 is a 'public works' contract, then following a suggestion made by the ECJ in La Scala, the only possible way of complying with the public procurement regime would be for the landowner to procure the works as it were a contracting authority. So even after *Müller*, we may have cases where we are led to the absurdity of the owner and developer advertising for the benefit of his competitors. This is why I

favour the wide reading of the planning exception, so that no proper s.106 agreement may be caught by the public procurement rules.

Conclusion

57. I favour the wide interpretation of the planning exception, yet the narrow interpretation is also plausible. It remains to be seen which reading of the law will prevail. There are strong forces inside the Court of Justice that push for the ever expanding scope of the procurement rules. I doubt that *Müller* will be the last word on the subject.

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