



Guidance on material change in procurement contracts – The Supreme Court in *Edenred v HM Treasury*

On 1 July the Supreme Court delivered its long awaited judgment in the case of *Edenred v HM Treasury and others* ([2015 UKSC 45]). *Edenred*, together with the Childcare Voucher providers Association, challenged the decision of HM Treasury to enter into arrangements that modified an existing public contract (the “*Atos Contract*”) between National Savings & Investments (“*NS&I*”) and Atos UK Limited (“*Atos*”).

Edenred claimed that the modification amounted to a material variation of a public contract, contrary to EU and UK procurement law and that, therefore, the decision of NS&I to deliver the new tax-free childcare scheme (“*TFC*”) through the *Atos* contract was unlawful.

The Supreme Court upheld the decision of the Court of Appeal and refused *Edenred*’s claim, holding that the variation of the *Atos Contract* was permitted by procurement law.

The judgment is of interest for a number of reasons, not least that:

- It provides useful guidance on the law on material change under the new Regulation 72 of the Public Contracts Regulations 2015; and
- It throws open an interesting debate over the extent to which public bodies may procure contracts in such a way to allow the addition of significant additional services, including for the benefit of other public bodies.

Facts

The Atos Contract

In 2013 NS&I entered into an outsourcing contract with Atos for the provision of operational services. The scope of the services was broad, including processing customer interactions, sales, after sales support, payments, IT development and market research amongst others services.

The contract notice stated that:

- NS&I was purchasing on behalf of other contracting authorities (referred to as “**B2B**” services) and that it envisaged significant growth in this area;

- The contract was for a duration of 8 years (+ a 3 year extension); and
- The estimated value was “**up to**” £2bn, with a likely range of £150m to £1.25bn depending on the uptake of the B2B services.

Atos was selected following an extensive competitive dialogue procedure. The contract was awarded in May 2013 with an initial value of £660m. Service provision began in April 2014.

Tax-Free Childcare

TFC is a new government scheme to provide an alternative basis for providing families with tax relief to assist with the cost of childcare.

Having taken part in early consultation with HMT/HMRC on the delivery of TFC, *Edenred* was disappointed that HMT/HMRC, who had been approached by NS&I, instead chose to provide the TFC services through the *Atos Contract*.

The New Contractual Arrangements

NS&I and HMRC entered into a memorandum of understanding setting out HMRC’s requirements which NS&I would deliver on its behalf.

The *Atos* contract was then varied to include a new schedule containing details of the services Atos must provide to NS&I.

The proposed variation had a term of 5 years and a value of £132.8m.

Edenred so far

Readers may be familiar with the passage of this case through the courts.

On 27 October 2014, Leggatt J refused an application by HMT to lift the automatic injunction that prevented the modification from taking effect.

In late November 2014, the High Court (Andrews J) rejected *Edenred*’s claim that there was a material change to the *Atos Contract*, in part because no contract can have been entered between two central government entities.

In March 2015, the Court of Appeal upheld the decision of the High Court, confirming no material variation had occurred. Undeterred, Edenred pursued the claim to the Supreme Court.

We have been following the case in our articles [Procurement clarification on material variation and internal public authority awards](#) and [A change in the balance of commercial interest requires a public contract to be tendered](#).

Judgment

Applicability of the 2015 Regulations

The Supreme Court confirms that despite Edenred raising its challenge under the Public Contracts Regulations 2006, it is the 2015 Regulations (which came into force on 26 February 2015, after the claim was brought) that apply when considering the issue of material change.

The 2015 Regulations provide six grounds where a contract may be modified during its term without breaching procurement law. Two of the grounds were relevant in relation to the amendment of the Atos Contract.

Were the Modifications of the Atos Contract substantial?

Regulation 72(1) provides that:

- “contracts... may be modified without a new procurement procedure...:
- ... (e) where the modifications, irrespective of their value, are not substantial within the meaning of paragraph (8).”

Regulation 72(8) will be familiar to readers as the ‘old’ law on material change – from the case of *Pressetext*. It states that:

A modification of a contract... during its term shall be considered for the purposes of paragraph (1)(e) where one or more of the following conditions is met:

- a. the modification renders the contract or framework agreement materially different in character from the one initially concluded;
- b. the modification introduces conditions which, had they been part of the initial procurement procedure, would have –
 - i. allowed for the admission of other candidates than those initially selected;
 - ii. allowed for the acceptance of a tender other than that originally accepted; or
 - iii. attracted additional participants in the procurement procedure;
- c. the modification changes the economic balance of the contract or framework agreement in favour of the contractor in a manner which was not provided for in the initial contract or framework agreement;
- d. the modification extends the scope of the contract or framework agreement considerably.

Edenred had originally argued that both limb (b - allowing admittance of other candidates) and (c - a change in the economic balance) were satisfied, but dropped these arguments by the time the case reached the Supreme Court. This left a claim that the modifications to the Atos Contract were substantial under limb (d) because the scope had been extended ‘considerably’.

The Court gave little credit to this argument stating that the Atos Contract clearly foresaw the expansion of the B2B services up to the £2bn maximum; the nature of the services was “*essentially the same*”, and the Atos Contract prescribed that any variation must not alter the economic balance of the contract or increase the profit margin available to Atos.

As a result, Hodge J stated that “*Economic operators can have been in no doubt as to the extent of the services they might have to provide to NS&I.*” The prohibition on modifying contracts to encompass services not initially covered did not amount to a ban on services being delivered during the term of a contract that are not delivered at commencement.

Was the review clause clear, precise and unequivocal?

Whilst this was enough to decide the case, Hodge J provided useful further guidance on the use of review clauses as a means of permitting change. He focussed on the level of specificity required to make such clauses effective, which he saw as the “*most significant*” restriction within Regulation 72(1)(a).

Regulation 72(1)(a) permits amendments to public contracts where “*modifications, irrespective of their monetary value, have been provided for in the initial procurement documents in clear, precise and unequivocal review clauses...*” provided that such clauses:

- i. *state the scope and nature of possible modifications or options as well as the conditions under which they must be used, and*
- ii. *do not provide for modifications or options that would alter the overall nature of the contract...*”

Hodge J held that the clause was sufficiently clear, precise and unequivocal because it:

- Envisaged the extension of the operational services provided by Atos to include B2B services;
- Restricted the changes to those within the scope of the contract notice; and
- Set out the principles that governed the incorporation of the new B2B services into the agreement, by limiting the profit margin and any alteration in the allocation of risk.

Impact

What can authorities do to make sure additional services are within the initial scope of the original procurement?

When a public body wishes to procure a contract under which additional services may be procured, they should take the following steps to mitigate the risk that the amendments may amount to a material change:

- Ensure that the maximum estimated value of the contract is sufficient to accommodate additional services;
- Select bidders on the basis of standards for performing a contract of the value and scope including the additional services;
- Describe the additional services that may be delivered in the contract notice, by reference to CPV codes and in the narrative description and state that the review clause will only be effective to incorporate these services;
- State clearly that any variation must not increase the contractor's profit margin or reallocate risk in favour of the contractor;
- Where relevant, state that the authority is procuring on behalf of other contracting authorities in the initial procurement documents.

What can authorities do to ensure that review clauses permit future amendments, without triggering a material change?

The precision of a review clause will determine whether or not changes effected through it may be legally compliant. Whilst every contract will be different, authorities should:

- Always consider at the outset of any procurement whether additional services are needed, or may be desirable. If so, a review clause should be included;
- Include a mechanism so that any review clause may only be implemented:
 - i. To incorporate services envisaged by the initial procurement documents;
 - ii. When there is no alteration in the allocation of risk in favour of the contractor;
 - iii. When the contractor does not receive a greater profit margin for the additional services. For example, new services may be based upon marginal prices for existing services.

An alternative to framework agreements?

The Supreme Court alluded to the fact that *"there may be circumstances in which a court could conclude that a public authority had designed a contract as a means of avoiding its obligations under EU law"*, but that in this case the scale and nature of the additions to Atos Contract appeared to be within a *"reasonable compass"*.

The Atos Contract effectively allows any central government body or local authority to enter into similar arrangements as HMT did for the provision of the operational services. This presents an attractive alternative to procuring the services (in terms of cost, time and risk of challenge).

This presents an arrangement similar to a framework agreement, but instead:

- The duration of the *'amended'* portion of the contract may be for as long as the existing contract has to run. Contrast this to a framework agreement, which is limited to 4 years, with 4 year call-off contracts. Would it be permissible, for example, to put in place a 25 year contract?
- HMT/HMRC have no rights to enforce the contract – only NS&I does. Contrast this to a call-off contract, where (for example) NS&I manage the framework, but HMT/HMRC enter into a call-off contract with Atos.

Contracting in this way may be attractive to government to reduce the financial and administrative burden of tendering for new contracts – especially for longer term, known requirements that are common to many public bodies.

What is not clear is where the line is drawn. Where does the addition of services cease to be within the *"reasonable compass"* when the addition of services becomes an intentional avoidance of the procurement regime, either because the scope of services is too broad, or because the duration of the contract too long?

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