Errors in major public procurement projects—learning lessons from the legal fallout (NDA v EnergySolutions EU Ltd)

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Public Law analysis: An independent inquiry has been launched into the flawed public procurement procedure concerning a major public contract for the decommissioning of nuclear facilities. The government terminated the Magnox contract and settled related litigation with claimants EnergySolutions and Bechtel. Richard Hanstock, barrister at Cornerstone Barristers, analyses the background to the dispute and looks at the terms of the independent inquiry.

Original news

Government terminates major nuclear decommissioning contract early and launches inquiry, LNB News 27/03/2017 54

The Nuclear Decommissioning Authority (NDA) determined that the amount of work needed to decommission 12 redundant Magnox sites was so much larger than specified in its contract with Cavendish Fluor Partnership (CFP) it amounted to a 'material change' in the terms specified during the tender process. The NDA therefore decided to terminate its contract with CFP with two years notice. The contract will be terminated in September 2019, after five years rather than the full 14-year term, and arrangements made for a new contract to be put in place for the remaining works. The NDA agreed to pay out close to £100m to settle the cases against it in relation to the award of the contract and withdrew its appeal. An independent inquiry into the 2012 public procurement process will be conducted.

What is the background to the Magnox decommissioning contract and related public procurement challenge?

The NDA presided over a complex public procurement exercise for the award of a major public contract for the decommissioning of 12 nuclear sites. The procurement process ran between 2012 and 2014, when the preferred bidder, Cavendish Fluor Partnership (CFP), was selected by a very narrow margin—rival consortium bidder Reactor Site Solutions (RSS) achieved a score of 85.42% against CFP's 86.48%.

RSS issued three sets of proceedings against the NDA in 2014 and 2015, alleging various breaches of the public procurement rules. These claims were heard together by Fraser J, who gave a lengthy and damning judgment in July 2016 (see: *EnergySolutions EU Ltd v Nuclear Decommissioning Authority* [2016] EWHC 1988 (TCC), [2016] All ER (D) 16 (Aug)), identifying a wide range of failures by the NDA in the procurement process. The Technology and Construction Court found that CFP should have been disqualified from the competition for failing to meet two threshold requirements, and in any event RSS would have won the tender process, but for a series of manifest errors that would otherwise have seen RSS achieve a score of 91.48%, against a reduced score for CFP of 85.56%.

The NDA made an interim application for a preliminary ruling that the failure by RSS to begin its first claim before the contract had been entered into broke the chain of causation between any breach by the NDA and the loss suffered by RSS, because a timely claim would have engaged a statutory bar on the NDA entering into the contract with CFP. The Supreme Court ultimately rejected this argument. The proceedings settled shortly before the Supreme Court ruling. A written ministerial statement of 27 March 2017 outlined a settlement figure costing the government in the region of £100m. Following this announcement, there was a sharp drop in the share price of Babcock International, one of the companies behind CFP.

An interesting side issue emerged shortly before hand-down by Fraser J. In July 2016, the NDA discovered that the claimant's witnesses were to be paid six-figure bonuses in the event that the claim was successful. Following further cross-examination by the NDA, it applied to dismiss or re-try the claim because of these corrupt payments. Fraser J rejected this assessment, and found that dismissal or retrial would be 'wholly disproportionate' (para [934]) and 'opportunistic' (para [939])—the application coming five days after the receipt by the NDA of a draft judgment on its liability (paras [62] and [939]). The existence of this arrangement was held not to go to the witnesses' competence, but to the weight to be afforded to their evidence—ultimately, Fraser J found that there was no such impact on the facts.

What do you think led to the NDA decision to terminate the Magnox contract and withdraw its appeal in the related legal challenge after it was heard by the Supreme Court?

The written ministerial statement identified two ‘separate issues’ deserving of examination:

- the 2012 procurement exercise (which was ‘flawed’ and ‘defective’), and
- the 2014 contract it had produced (which had ‘proved unsustainable’)

The issues with the public procurement exercise have been well-aired over the course of the litigation, but the latter issue is rather more opaque. The minister described the problem as stemming from ‘a defective procurement, with significant financial consequences’, given the terms of the judgment of Fraser J, and the magnitude of the settlement figures, this is something of an understatement. An independent inquiry has been established in order that the reasons for the failures be ‘exposed and understood’, with a view both to learning lessons for the future and to pointing fingers of blame.

What were the key grounds raised in the legal challenges which have now been settled?

The key issues in the litigation concerned:

- the applicability of the *Francovich* conditions to the procurement regulations (see *Francovich v Italy*, Case C-6/90), and
- whether the failure to issue proceedings during the statutory standstill period amounted to a break in the chain of causation

On the first issue, the Supreme Court has now confirmed that the relevant public procurement regulations are to be read as providing for damages only where the *Francovich* conditions are satisfied—that is, where:

- the rule confers rights on individuals
- the breach is ‘sufficiently serious’, and
- there is a direct causal link between the breach and the loss

This overturns the finding by the Court of Appeal that a breach of the public procurement regulations is essentially a breach of statutory duty in domestic law, which is not subject to any ‘sufficiently serious’ threshold. The UK Supreme Court found that Parliament had intended to take only the minimum steps necessary to comply with EU law, and had not intended to ‘gold plate’ the EU Public Procurement Directive 2014/24/EU by expanding the right to damages beyond those claims that pass the *Francovich* threshold.

On the causation issue, the Public Contracts Regulations 2006, SI 2006/5 (and its successor, the Public Contracts Regulations 2015, SI 2015/102) provide a standstill period during which, if a claim is begun by an unsuccessful bidder in the days following notification of a public procurement decision, the contracting authority cannot enter into a contract with the winning bidder without leave of the court. The Supreme Court found that a failure to commence proceedings within this standstill period does not break the chain of causation, and it is for the contracting authority (and, in practical terms, the winning bidder) to take the risk of entering into a contract after a defective public procurement process. In essence, the standstill period is a shield (for the losing bidder) and not a sword (for the contracting authority). As it was put by Lord Mance at para [56], the losing bidder ‘cannot be said to be acting unreasonably if it fails to stop the authority from perpetrating a breach of duty which the authority could itself stop perpetrating’.

This essentially turns the NDA’s argument on its head. The Supreme Court ruled that notwithstanding the statutory standstill period, it is for the contracting authority to bear the risk of implementing its decision where this is based on a flawed process—even if it is not aware, as in many cases it will not be, of any defect that might give rise to subsequent liability in damages. Although this potential liability is mitigated by the application of the *Francovich* conditions, and by the doctrines of manifest error and margin of appreciation, this ruling makes clear that contracting authorities face considerable litigation risk from defects in the procurement process. This underlines the importance of assurance, transparency, and self-policing in the administration of public procurement processes, and contracting authorities would be well advised to review their own processes with these aims in mind.

The impact of the settlement on the share price of Babcock International Group further indicates that the winning bidder bears some degree of commercial risk as well, suggesting that it would be prudent even for the successful bidder to satisfy itself that the public procurement exercise is not flawed. This may lead to closer scrutiny of public procurement processes as part of even the winning bidder's due diligence processes.

Although the proceedings settled before judgment was handed down, the Supreme Court (at the parties' request) went on to hand down judgment on 11 April 2017 (see *Nuclear Decommissioning Authority v EnergySolutions EU Ltd* [2017] UKSC 34, [2017] All ER (D) 53 (Apr)). This is a welcome step, because the judgment does clarify important areas of uncertainty in procurement law. The settlement has no impact on the status of the Supreme Court ruling as authority.

The Supreme Court's decision is the subject of separate analysis: Assessing the Supreme Court's approach to public procurement challenges & remedies (NDA v EnergySolutions EU Ltd).

What are the terms of the independent inquiry into the Magnox procurement and when will it report?

The Holliday Inquiry, headed by former National Grid CEO Steve Holliday, is expected to report jointly to the Energy Secretary and the Cabinet Secretary. Its terms of reference are wide-ranging, and are not limited to the actions of the NDA and its subsidiaries, but also of other government departments. As well as setting out lessons for the future—in particular on the subject of governance and assurance, it may make any recommendations that it sees fit, including as to matters of discipline. This chimes with the expectation that the inquiry should not only expose the reasons for the various failures, but also indicate who should be held to account for these failures.

The epic judgment of Fraser J (see *EnergySolutions EU Ltd v Nuclear Decommissioning Authority* [2016] EWHC 1988 (TCC), [2016] All ER (D) 16 (Aug)) will be a most useful jumping-off point for the Holliday Inquiry. The High Court there set out, in grotesque detail, a series of public procurement failures by the NDA, particularly relating to transparency and accountability. In particular, Fraser J criticised even the contemplation by the NDA of 'any policy that would involve the routine destruction of such important documents' as contemporaneous notes created by subject matter experts scoring technical aspects of the competing bids. Remarkably, such a policy appears to have been motivated by a desire to reduce the volume of disclosable material in any subsequent procurement litigation (para [269]).

The High Court clarified that while there is a 'margin of appreciation' in relation to matters of technical judgment, the 'manifest error' threshold does not confer similar leeway in relation to obligations of equality or transparency (para [276]). Given these criticisms, I would expect the Holliday Inquiry to produce detailed guidance on record-keeping and transparency, notwithstanding the fact that this topic is not specifically framed in the terms of reference set out in the written ministerial statement.

No formal timetable has yet been announced for the Holliday Inquiry to report and further detail is unlikely to materialise in this parliamentary session, but in light of the judgment of Fraser J in particular, it would be surprising if the inquiry was to be especially protracted, notwithstanding its apparent breadth.

What can contracting authorities learn in the meantime?

The central messages that emerge from the litigation are that:

- contracting authorities must be meticulous in their record-keeping and transparent in their public procurement processes, and
- the margin of appreciation, even on technical issues, cannot excuse material error

While the *Francovich* conditions should deter all but the most deserving claims, I expect this line of cases to renew confidence in the right to challenge public procurement decisions, and contracting authorities of all sizes should review their processes to identify opportunities to improve transparency and provide assurance at proportionate cost, so as to batten down the hatches against legal challenge.

For further information on the case law cited in this interview, see our UK public procurement case tracker.

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