

The main legal and ethical issues with cancelling procurement contracts

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For obvious reasons, in recent weeks contracts with Gazprom Energy, a UK subsidiary of the state-owned Russian company, have been a hot topic of discussion amongst political bodies and media outlets. These contracts supply either gas or both gas and electricity to a number of public sector organisations including local authorities, hospital trusts and schools. The big question for these public sector bodies has been whether they can legally cancel their contracts with Gazprom (and indeed whether they should morally) and, going forward, if they can remove a particular supplier from future competitions.

A local authority spokesperson said, 'At the time of procurement, Gazprom put forward the best case to supply services in accordance with the legal obligation on local authorities to obtain best value,'... 'By law, a local authority cannot discriminate against an economic operator for non-commercial reasons, such as country of origin, political affiliation or involvement with governmental policy, other than if directed by policy of central Government.

Under the Local Government Act 1988 ("LGA"), local authorities are banned from considering the location or origin of a bidder and any political or sectarian affiliations when awarding contracts. However, Section 19 of the LGA gives the Secretary of State for Levelling Up, Housing and Communities and Minister for Intergovernmental Relations power to amend such provisions. From Gazprom's perspective, the supplier has a legal right to exercise its option to bid for a tender if they can meet the expectations set out. Considering this, there have been calls on the UK Government to clarify if local authorities can lawfully refuse to deal with state-owned firms. The Public Contract Regulations 2015 ("PCR") allows contracting authorities to limit or exclude certain suppliers from bidding if a company is involved in fraud and money laundering or is on a sanctions list, but the PCR refers to individual operators rather than nations. Currently, whilst the nation of Russia and some of its individuals have been sanctioned in the UK, this does not include the UK arm of Gazprom or the individuals on its board.

Paul Dennet (Salford mayor) and Mark Allison (leader of Merton LBC) have written a letter to the Secretary of State for Levelling Up, Housing and Communities and Minister for Intergovernmental Relations, Michael Gove, requesting amendments to current legislation and for the UK Government to sanction Gazprom to accommodate local governments to be able to legally limit bids from Russian state-owned companies and to keep in line with the UK's stance on Russia.

Whilst we wait for more guidance on this matter, local authorities have been checking the termination provisions of their contracts with Gazprom, but without a double financial whammy it is difficult. Firstly, the contracts could be expensive to terminate if outside of the 12-month cycle. Secondly, the price of utilities now is much higher than when many contracts were procured, meaning entering into a new contract for electricity and/or gas would be much more expensive.

The Government is set to release further details in due course to ensure that local authorities can comply with the restrictions on Russia, but in the meantime, should they want to change supplier, public bodies can choose to bulk-buy their energy supply with other public bodies through Crown Commercial Services' energy procurement agreements.

There are some more subtle points to be aware of in relation to Gazprom contracts:

- The contracts don't contain a reference to the bank into which payments are made. A number of Russian financial institutions have been listed as designated persons, to whom payment would represent a breach. That should be checked before a further payment is made;
- Further enquiries about the beneficial owner(s) or controllers of Gazprom Energy would be useful. It is a breach to make payment to an entity that is owned or controlled by a designated person, where that designated person:
 - holds directly or indirectly more than 50% of the shares in Company,
 - holds directly or indirectly more than 50% of the voting rights in Company, or
 - holds the right directly or indirectly to appoint or remove a majority of the board of directors of Company.

Despite the above, there may be logistical matters that make the performance of the contract by Gazprom difficult. Russian ships are now prevented from entering UK ports. This, in addition to the banking restrictions described above, may have an impact on supply; although non-Russian ships may, of course, step into the breach. This may create a force majeure situation which could be exploited, but it is not a quick fix and does not provide a position solution to the problem of having to pay up to seven times more for utilities at today's prices.

The final point to consider would be the ethics around the procurement of energy contracts. Currently all local government bodies will have sustainable and ethical procurement policies in place, and it will be interesting if emphasis on the ethical issues surrounding procurement will be legally relevant to cancelling contracts and stopping future bidding processes with such entities.

To conclude, there is a lot of uncertainty surrounding this area, with more clarity required from the UK government. Currently the best option for public sector organisations will be to seek legal advice on your current position if you are wondering whether you can cancel your energy contracts, until more guidance is provided by the government surrounding the current legislation.

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