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23 April 2018

Dear Sirs

Pre-Action Protocol Letter : Proposed Claim for Judicial Review / action in relation to public procurement breaches

Decisions of Borough of Bournemouth Council on 27 February / 6 March 2018 to approve the funding of the construction of a hotel on the site adjacent to Bournemouth International Centre (BIC)

A To:

1. The proposed defendant is The Council of the Borough of Bournemouth of Town Hall, Bourne Avenue, Bournemouth, BH2 6DY (the Defendant).

B The Claimants:

2. Bespoke Hotels Limited
Bespoke House
5 Bankside
Crosfield Street
Warrington
Cheshire

3. Peel Hotels PLC,
19 Warwick Avenue,
London,
W9 2PS

4. (the Claimants).

C The details of the matter being challenged:

5. The decisions being challenged are the decision of the Cabinet of 27 February and the decision of the Full Council of 6 March (collectively the **Decisions**) to endorse and approve "the investment in

the construction of a hotel on the site adjacent to the BIC" and to make consequential changes to the budget of the Council.

6. The factual background to the matter subject to challenge, as we understand the position, is set out below:

a. The avowed intention of the Defendant is to "see a new hotel developed on the site adjacent to the Bournemouth International Centre" (the **Project**). This is to be achieved, according to the Defendant, through "playing an active role in the town's economy, including investing in tourism". Through such measures it is the Defendant's intention to "strengthen its key industries".

b. In furtherance of such policies the Defendant entered into a development agreement in May 2011 for the development of the site. The selected partner secured a planning permission for a 208-bedroom four star hotel, with 30 apart-hotel rooms. This scheme did not progress beyond planning as the developer could not raise funding and the development agreement was terminated by the Council on 27 September 2015. This is strong evidence that the scheme is not commercially viable or fundable for a market operator.

c. In particular the Project site is constrained, being surrounded on three sides by busy roads. It currently comprises a bare hill – itself situated on a slope – with a 10 metre high retaining wall along its southern flank. It is a very difficult site to develop, technically, resulting in very high level of abnormal construction costs and a relatively inefficient "horseshoe" shaped building. The site is not a natural candidate for large-scale development.

d. In February 2016 the Defendant initiated a public procurement procedure to select a partner to fund, construct, and manage a training hotel, which would be owned by the development partner on a long (125+ year) lease (the **First Procurement Procedure**). A condition of the draft contract documents was (and continues to be) that the partner procures an internationally recognised hotel brand to operate the hotel for a minimum period of 10 years. Another requirement (which was subsequently dropped) was that the development partner should, in addition to demonstrating a fully funded development plan, also provide a Bank guarantee or comparable security in favour of the Defendant totalling approaching 50% of the building contract sum. Whilst this was unrealistically onerous, the Defendant was right to seek a multi-million pound financial commitment from a creditworthy party to protect the scheme from being abandoned if the developer encountered problems.

e. During 2016 the Defendant worked with a shortlist of three bidders. In March 2017 council officers reported to Cabinet that its initial public procurement procedure had failed. Cabinet decided, on the advice of officers, that the procedure had resulted in no acceptable bids. As a result of this outcome, the Cabinet materially changed the basis of the tender process. The new process adopted by the Defendant included a provision that allowed for all development funding to be made available by the Defendant.

f. The implications of this change are worth dwelling upon. Assuming the Project proceeds under the revised terms, the Defendant shall provide all of the development funding and in so doing, shall become a hotel owner. Market sources inform us that in normal market bank lending it would only be possible for a developer to obtain around 50% of the funding for a new regional hotel development on a franchise agreement on a non-recourse basis, due to lack of certainty over income and banks' requirement for substantial equity. Additional lending, if at all possible, would come at much higher interest rates, and 100% development lending is, we understand, impossible to obtain. By this measure, the terms being offered by the Defendant are clearly not commercial terms.

g. The material change to the tender process would undoubtedly have greatly increased the attractiveness of the Project to the market in general. On this basis the Defendant began a "negotiated" process to determine its preferred partner (the **Second Procurement Procedure**). In the opinion of the Claimants, the Defendant could have attracted a much higher calibre of bidder by re-tendering. Instead the Defendant decided to proceed with the same short-list of three tenders that had submitted tenders in response to February 2016 procurement procedure, despite the material change to the terms of the tender.

Outcome of the competition

h. The preferred bidder for the Project is an entity formed by Mill Lane Estates (**Mill Lane**) and Marick Real Estates.

i. It has come to the attention of the Claimants that certain directors of Mill Lane appear to have a poor track record in the delivery of schemes similar to the Project. We are informed that persons by the name of Glen Mills and Brandon Riley, who appear to be directors of Mill Lane Estates Limited, were also directors of GB Development Solutions Limited, which is in administration. We understand that GB Development Solutions Limited and its parent played a significant role in a £32 million Hilton hotel project at Leeds Arena which failed, after receiving a loan from the public sector of £4.8m. The loan "will not be recovered" according to reports in the local press. The developers of the Leeds hotel scheme apparently went into administration after works on the foundations had been completed in 2016.

Characteristics of hotel franchise agreements similar to the Project

j. The Project comprises two franchised IHG-branded hotels. IHG is not a tenant. Generally, major international hotel brands such as Hilton and IHG do not enter into property leases for new hotels. Instead such hotel companies enter into management or franchise agreements where they act as service-providers only. Under such agreements it is the building owner, not the hotel company, that:

- owns both the hotel property and the hotel business.
- is obliged to deliver a "turnkey" brand-compliant hotel at its own cost (the hotel company does not fund capital or operational costs)
- has no certainty of income – just a future profit (not rental) stream
- employs all hotel staff and enters into supply contracts

k. The hotel company provides its brand to the building owner and it (or a specialist third party operator) operates the branded hotel as a service provider for fees payable by the building owner. The building owner, therefore, is equivalent to a shareholder in the business, and the hotel company (or specialist third party operator) is the manager of the business. The building owner receives an annual profit stream often referred to as net operating income (**NOI**) goes up or down from year to year as with any trading business. It is for this reason that hotel lenders will only lend relatively low amounts for development of hotels on management or franchise agreements as opposed to much higher percentages for hotels leased to creditworthy operators such as Premier Inn and Travelodge.

Capital outlay

l. The construction cost of hotels with a total of 322-beds on the site adjacent to the BIC is estimated at over £64m. The Claimants understand that the construction cost of a comparator hotel scheme nearby in 2015 (albeit with 10% fewer rooms) was under £40m. This speaks to the unsuitability of the site for large scale hotel development. Assuming construction costs are in the region £64m, total development costs would be around £70m[1].

Valuation and viability

m. The valuation of the Defendant's interest is determined by applying a valuation multiple to its rental income. We are informed that the Defendant is expecting to receive at least £3.5m rent and is justifying its involvement with the Project on this basis. For this to be a viable business model, the combined NOI from the hotels and car park obviously has to exceed this sum, with excess being retained by the developer (subject to some element of turnover rent). Based on current valuation multiples and the proposed developer-tenant's financial standing, the Claimant's believe that if stabilised NOI from the Project were as high as £3.5m per annum (a sum which would only cover the Defendant's rental payment and roughly in line with market expectation for hotels of that size and type in the Bournemouth market), the end value of the Defendant's interest in the scheme would be no more than £40m. The Claimant's understand that this is consistent with the valuation provided to council members in 2017. So the expectation then was that the value of the Defendant's interest in the Project would be in the order of £30m less than its assumed £70m total development cost.

n. It appears from recent Committee reports that the Defendant's proposal is contingent on procurement of an insurance policy for the first 10 (of 35) years of rent from the Developer tenant. Market sources inform us, having spoken to specialist hotel lending teams at HSBC and NatWest/RBS, that no hotel lender has ever lent on a large scale hotel development on the basis of hotel income being covered by insurance, and that such an insurance would not available in any event from any high investment grade insurer of the same financial standing of, say, Aviva or Zurich that the Banks would (and the Defendant should) insist upon in the context of a 10 year risk.

o. To emphasise the point that such insurance is scarce for a hotel scheme of the size and risk profile (if it is available at all), the only provider of such insurance that the Claimants have knowledge of ever offering this insurance product, CBL, went into administration in late February. This emphasises that rent insurance from a reputable, high investment grade insurer would be scarce for a hotel scheme of comparable size and risk profile or, more likely, not available at all.

p. Even if such insurance were procured from a creditable insurer the Claimants do not believe that paying a premium of £2-3m to cover the first 30% of the lease term can increase the end value of the Defendant's interest in the Project from c.£40m to more than its c.£70m total development cost, otherwise all hotel developers (indeed all property developers and all property owners) would take out such insurance. If any professional adviser has advised that this is the case, then it would be prudent for the Defendant to insist that the adviser provide such valuation advice formally, with underlying assumptions stated, along with an undertaking that their professional indemnity insurance would not be limited to an amount less than £30m in this

[1] Of the £70m, approximately £64m is represented by the estimated build contract price. The balance would include professional fees, hotel pre-opening costs, finance costs and the rent insurance premium (see below) if the developer is not funding it and a contingency.

regard. If a professional adviser has not advised that this is the case then the assumption is manifestly unsafe and illogical.

q. It is understood that Savills were not retained to provide valuation advice to the Defendant, only advice on the reasonableness of hotel trading projections. As such it must be the case that any valuation upon which the Defendant is relying must have been prepared or promoted by council officers without the benefit of professional indemnity insurance. In the context of a project involving the investment of £70m of public money the Claimants believe this to be reckless.

r. It is understood the Defendant is working on the basis that the "value of the hotel" would be £60m to £75m, compared to its £70m development cost – assuming that the hotel achieves its £5m per annum projected stabilised NOI. However, the £5m projected profits, and therefore the value of the hotel, are shared between the council (c.70%) and the developer (c.30%). So, even if the scheme achieved its £5m projected profits and even if the maximum hotel valuation was reasonable, then the value of the council's interest would be approximately £50m (70% X £75m assumed maximum hotel value) - still some £20m less than its £70m cost.

s. To conclude, based on projections and valuations that have not been endorsed by Savills, the Claimants understand that the Defendant is proposing to "invest" a sum of approximately £70m in an asset that will have, on the basis of the comparable information set out above: (i) little or possibly negative NOI after rental payments; (ii) a capital value that is several tens of millions less than the value of its investment; (iii) which would not be materially assisted by an insurance policy from a reputable provider, even if such a policy were to be available on the market.

The Project's forecast NOI

t. The Claimants are aware that IHG produced trading projections for other bidders for both a Crowne Plaza hotel and a Holiday Inn Express hotel (the **IHG Projections**). Based on these projections and other information highlighted in following paragraphs, the Claimants anticipate that the Defendant are relying on projections that show approximately £5m stabilised NOI for the Project. The Claimants understand that this is approximately 50% higher than the direct comparator figure in the town. The Claimants are not aware of any grounds for assuming that the Project will outperform the direct comparator hotels' current performance at all, let alone to such a degree. Benchmarking against this comparator would mean there would be little or no surplus above the proposed annual £3.5m annual rental payments that the Defendant expects to receive from the Project, in the view of the Claimants. In turn, disclosure of this material fact to a prospective rental income insurer (if any can be found) might render any rent insurance policy unviable.

The Project's health club and car park revenue projections

u. The Claimants are aware of a direct comparator hotel's 2017 health club/spa revenues were "under £300k" based on a health club membership of approximately 200 members (against capacity of approximately 400 members) from a 7,000 square foot facility. Usage of the spa by health club members (as opposed to hotel guests and day visitors) is reportedly minimal.

v. Compared to the above, the IHG Projections showed higher stabilised revenues for the planning permission scheme (which includes a c.16,000 square foot leisure facility), consistent with a membership of c.800 to 1,000 members. The Claimants believe this to be too optimistic for a town-centre hotel health club that isn't run by a specialist operator and without free car parking.

w. In stark contrast, the Claimants understand that the Defendant has justified its proposed investment in the Project on the basis of projected health club/spa revenues of c.£1.8m p.a. and car parking income at c.£650k. The Claimants note that:

i. health club/spa revenues are 6X those achieved by the closest comparator Bournemouth hotel.

ii. health club/spa revenues and car park revenues are both (several) multiples of those projected by IHG themselves (in the IHG Projections) based on the current planning scheme.

x. The Claimants note that:

i. The impact of the additional c.£1.5m of health club/spa and car park revenues would be to increase the Project's projected hotel NOI by over £1m compared to the comparator hotel figures and IHG Projections. Assuming an average c.£40 monthly membership fee (including VAT) a membership of c.3,500 would be required to support health club revenues of £1.8m, and the facility would need to approximately double in size to c.30,000 square feet.

ii. If this assessment is correct, then the enlarged health club would be on a par with the Village Hotel as the Town's biggest. However, Village Hotels are a specialist, national health club-led hotelier and operate a large health club and relatively small hotel from their spacious edge-of-town location that includes c.300 free-of-charge surface car park spaces. In contrast, the Project's proposed health club/ spa would be constructed in a high build cost, constrained town centre location, without a specialist health facility operator/manager to operate and market it, and without free car parking.

iii. In order to achieve a membership of c. 3,500 the Project will need to divert demand into the Town Centre from the Village Hotel (£40-45 per month/ free car parking) or from the only major Town Centre operator, BH Live, who operate the Defendant's own health club venues at a lower price point (£28-36 per month). Otherwise, the hope must be that the majority of the 3,500 members will be those that do not hold existing health club memberships. This is highly speculative.

The Project's room revenue projections

y. The Claimants understand that the room rates in IHG's Projections are materially out of line with those achieved by comparator hotels. If the Defendant's projections are based on similar assumptions, then the Project's forecast room revenues will also be too optimistic. Profitability is highly geared to room rates. So adjusting rates downward by £5 per room, say, would result in a reduction to the Project's projected NOI of c.£300k.

z. Furthermore, as noted above, the Claimants understand that room revenues from across the Bournemouth market in the first quarter of 2018 were in the region of 7% lower than 2017. This highlights that it is not safe to assume that projected inflationary increases in room rates (as opposed to costs) will be achieved every year from now to hotel stabilisation and beyond.

aa. Finally, the Claimants do not believe there is market capacity for the additional 322 IHG bedrooms without materially impacting rates and occupancy in the whole market – including those of the Defendant's Project and the Claimants' hotels, and other the hotels in the Town.

The Claimants believe, however, that it is the Town's heritage hotels would likely be most severely impacted if the Defendant pursued this unviable Project, with closures being inevitable.

Conclusion on trading projections

bb. It is the Claimants' belief that the projected £5m NOI has not been endorsed by Savills and has been inflated by unproven and highly speculative increases in health club/spa and car parking projections compared to both the IHG Projections and comparator hotels. The analysis in the preceding paragraphs sets out why the Claimants are of the view that the assumptions that underpin the Decisions are unduly optimistic, to say the least. The Claimants do not believe that the introduction of the largest health club in the town centre has been explained to or properly considered by Council members. If Savills had advised that the £5m NOI projections are achievable, then it would be prudent for the Defendant to insist that they provide such advice formally, along with an undertaking that their professional indemnity insurance would not be limited in this regard. If, as is believed to be the case, Savills have not advised that the £5m NOI projections are achievable then the assumptions, especially those in relation to the health club, are manifestly unsafe.

cc. Notwithstanding any debate on whether the projected NOI figures are achievable, it must be borne in mind that even if the Claimants' estimation for the projected NOI was to be achieved, the value of the Defendant's c.£3.5m rental interest in the scheme would still several tens of millions less than the £70m development cost as explained in paragraph 6 (r) above.

The Independent Review

dd. We note that that the Defendant has commissioned an independent review of the advice provided to it concerning the Project. The Claimants would welcome a genuinely independent expert review, but has concerns that what is being undertaken is not robust. The Claimants understands, on the basis of information available publicly, that the person appointed to undertake the review lacks experience in the hotels sector (and health clubs), being a specialist in infrastructure projects. Given the magnitude of the project, its significance for the Defendant and the gulf between the projected trading performance of the Defendant's proposed hotels compared to that actually achieved by comparable hotels, the Defendant should seek advice on the scheme from an independent expert source that has not previously advised the Defendant and that has relevant experience in the hotels and health club sectors.

Planning Risk

ee. The planning permission (Application 7-2015-4917-N) is for a 208-bedroom 4-star hotel and 30 apart hotel rooms, with car parking. The first iteration of the scheme (Application 7-2011-4917-J) was refused planning permission on the basis that *"... the massing of the building, its position and excessive height in relation to the Priory Road/BIC roundabout frontage ... would be out of character with the surrounding area, contrary to the aims of [relevant Policies]. .."* and that it *"... would have an adverse impact on the setting of the Listed Royal Exeter Hotel ..."*. The scheme had to be redesigned and cut back on all sides to fit in with surrounding buildings to be granted planning permission. So, it is relevant to note that in order to achieve projected revenues the scheme will need to be greatly increased in size to replace 30 apart hotel rooms with a 114-room 3-star hotel, the large increase of the health club facility to accommodate c.3,500 members and increased car parking provision. The underlying planning risk must be substantial bearing in mind the precedent decision. It is not clear that this has been properly explained to or considered by Council members.

Decisions of 27 February and 6 March 2018

ff. Through the Decisions the Defendant decided to proceed with the Project, subject to certain conditions: the conduct of the aforementioned independent review and the procurement of the a "10-year rent insurance policy of real substance and in a form that the Council can call upon to make up the full agreed rent payment shortfall". As noted above, the Claimants expect that the likely cost of the premia for such an insurance (if such a policy is available at all from a high-grade insurer or bond provider) would be at least £2-£3m if (and only if) the insurer gave credence to the Defendant's underlying reported £5m per annum profit projections. In the context of a 10 year exposure commencing in 2-3 years from now when the development might be completed, this highlights the need for the Defendant to procure any insurance policy (or rental guarantee bond) from a high investment grade insurer. The Claimants do not think that is achievable.

gg. No reference appears to the requirement for such insurance in the procurement process to date. Given the likely cost of securing such insurance (should it be available at all), it seems quite possible that this might have made a difference to the procurement, and could have resulted in a different tender being successful or different tenderers submit bids. These concerns are set out in more detail in Section E, below.

hh. It appears from the papers available, that the Defendant decided to proceed with the Project on the basis of its powers to "invest". In view of the extremely speculative nature of the Project, the reliance on such powers is unlawful. Indeed, the decision to fund the Project, at no capital cost to the selected developer, is extraordinary in view of the risks associated and the geo-technical challenges presented by the site. We would also question whether any market operator would act in such a way, giving rise to questions of unlawful State aid. These points are set out in more detail in Section E, below.

ii. The decision to fund the Project also raises concerns in relation to the Defendant's compliance with the revised Statutory Guidance relating to Local Government Investment produced by the Ministry of Housing and Local Government (the "Statutory Guidance") and compliance with the Prudential Code more generally. The Claimants fail to see how its interest in the new enterprise could have a value that is greater than the development cost, taking account of the likely costs of construction. This would place the Defendant in breach of the rules of the Statutory Guidance. Similarly, the lawfulness of the exercise of borrowing powers to support such a venture can be regarded as being of doubtful legality, noting the requirement set out in the Prudential Code. These points are set out in more detail in Section E, below.

jj. Without prejudice to the specific concerns raised above, we would also question whether the decision to proceed with the Project can be reconciled with the Defendant's fiduciary duties to citizens and business within the borough that together contribute a large part of the Defendant's budget (a class that includes the Claimant). The Claimants are particularly concerned, both on their own account and on behalf of the citizens of Bournemouth, that if this highly speculative venture were to fail (a prospect which seems disturbingly likely on the basis of the information set out in this letter) then there would be a real, adverse impact on the provision of front-line services. The Defendant would be left to service a significantly increased debt, backed by an asset which, assuming the Claimants' calculations are correct, would not cover the value of the "investment". On this basis, the approach of the Defendant seems to be the very antithesis of prudent borrowing and very far from discharging the Defendant's fiduciary duties. This points are is set out in more detail in Section E, below.

kk. The Claimants also note that no consideration appears to have been given to the Defendant's Section 123 Local Government Act 1972 and/or Section 233 of the Town and Country Planning Act 1990 (similar provisions apply to for land held for housing purposes) obligations to achieve best consideration for the disposal of the site in the Decisions. To decide to proceed without taking account of such an obviously relevant consideration appears, on its face unlawful insofar that there is no indication that any process has been followed to establish what the best consideration for the site of the Project should be. This point is set out in more detail in Section E, below.

Concluding comments

ll. The Claimants are at pains to make clear that this is not about seeking to restrict competition within Bournemouth; the Claimants welcome the addition of new accommodation to the town and new providers. However, the Claimants do question whether the Project will deliver the Defendant's policy objective. In particular, Councillor Broadhead's assertion made during the 6 March Full Council meeting that:

> *this investment adds to the regeneration of this prime seafront position, help to revitalise the ageing hotel stock in Bournemouth, adds to the growth of the BIC and bring some of the world's largest hotel brands to our thriving town, but it also serves as an excellent investment for Council Tax payers which should generate a significant return to help protect front line services*

rings hollow in light of the Claimants' view of the business case underpinning this "investment". In fact, it is the view of the Claimants that the Project will be an irresponsible use of precious Council resources, with a real risk of harm to frontline services, given the extent of the borrowing necessary to fund a project that the private sector have walked away from.

mm. The artificial increase in the supply of accommodation, in a way which is unrelated to existing (or forecast) demand, will very likely weaken the serviced accommodation sector of the tourism industry within the borough. As noted above, businesses most likely to be affected by this increase in competition are the traditional, heritage hotels, which the Claimants believe are an important part of the existing accommodation offer within the town.

7. To the fullest extent possible, the matters above will be the supported by witness statements when the claim is issued.

E. The issues:

8. There are three grounds for the proposed claim. The Claimants reserves their position in relation to raising additional grounds relating to the Project.

<u>Ground 1 : procedural and public law issues</u>

9. We consider that the Decisions to proceed with the Project are defective for a number of reasons under this ground:

Section 12 of the Local Government Act 2003

a. The power relied upon by the Defendant to proceed with the Project is set out in Section 12 of the Local Government Act 2003. That provision reads:

A local authority may invest—
(a) for any purpose relevant to its functions under any enactment, or
(b) for the purposes of the prudent management of its financial affairs.

b. We believe that the proposed expenditure cannot properly be considered to be an investment in any normal sense. It is an acquisition of works or services, as demonstrated by the fact that the Project was subject to a public procurement procedure. This approach is supported by recent judicial comment:

"Invest" in my judgment, has its normal meaning, and does not cover spending money for perceived public benefit long or short term. Further powers to enter contracts existed in s1(1) Local Government (Contracts) Act 1997 for the provision to it of assets or services.[2]

c. Even if we are wrong, and the Defendant's involvement in the Project can be categorised as an "investment", we would question whether the Section 12 power can be lawfully relied upon in these circumstances. As the Defendant will be aware, for a statutory body to lawfully exercise a power, it must do so for a proper purpose. It is our view, on the basis of the information imparted to us from the Claimants, that the Defendants proposed expenditure on the Project, as authorised by the Decisions, falls outside of the scope of the power as intended by Parliament. A transaction which, 3-years after completion results in an asset that is worth materially less than the sum expended upon, with an uncertain path to a positive valuation, is not what we believe was contemplated by Parliament when the provision permitting "investment" was enacted.

Departure from the Statutory Guidance

d. Taking at face value the assertion that the Project is a lawful "investment" (a point on which do not accept), we consider that the Project does not conform with the requirements specified in the Statutory Guidance, issued under Section 15(1) of the Local Government Act 2003.

e. The Defendant has materially departed from the Statutory Guidance in a manner which has not been adequately justified. In particular, and without prejudice to other concerns that we seek to raise in relation to the Defendant's compliance with the Statutory Guidance, we note that paragraph 37-40 suggests that local authorities should have an asset that can be realised in order to recoup all of its capital.

f. Demonstrably that will not be achievable in this case, noting the likely construction costs referred to above, and the likely asset value. Even with insurance in place, it seems inconceivable that such protection could be given that it would remedy in any meaningful way the very high likelihood of losses being incurred.

Section 1 Local Government Act 2003

g. Section 1 of the Local Government Act 2003 sets out a power to borrow and this is relied upon in the Decisions. The relevant part of that provision reads:

A local authority may borrow money … for any purpose relevant to its functions under any enactment

[2] Peters v Haringey LBC, [2018] EWHC 192 (Admin

h. As the exercise of this power is associated with the purported purpose of "investment", we believe that, to the extent that the Defendant's power to invest is not engaged in the circumstances, as described above, it becomes impossible to rely on this power to borrow to support the Project.

i. Even if the Project can properly be considered to be a lawful investment (a point which we do not accept), we would question whether sufficient regard has been taken of the Prudential Code for Capital Finance in Local Authorities (the **Prudential Code**). The Defendant is obliged to have regard to guidance specified under Section 3(6) of the Local Government Act 2003. Without prejudice to our development of any claim under this ground (and assuming the Defendant's position on the engagement of the "investment" power to be correct for these purposes alone) we do not see how, having regard to the key indicators identified in the Prudential Code, the borrowing could be considered prudential.

Breach of fiduciary duties

j. The *Charles Terrence Estates*[3] case re-established the relevance of fiduciary duties, with Maurice Kay, LJ commenting that the line of precedent "*established that some decisions of local authorities will amount to a breach of fiduciary duty or of a duty analogous to a fiduciary duty and that in public law proceedings at the suit of an interested party, the decision may be characterised as ultra vires and void*". The fiduciary duty requires that local authorities have regard to the interests of taxpayers and to balance this against the aims of a policy or the purpose of the relevant statute.

k. The fiduciary duty has been encapsulated as a duty to manage funds contributed by taxpayers efficiently and to use such funds to the "best advantage" of the authority. Judicial commentary in the area of fiduciary duty has also considered the importance of balancing interests between groups who are affected by a particular decision. Given the very wide potential harm that the Defendant's participation in the Project may cause, through increases in tax payment and business rates and/or cuts to front-line service, the meagre benefits of proceeding with a intervention on non-commercial terms appear to be comprehensively outweighed by such risks.

l. On the basis of the information provided by the Claimants and other market sources, it appears that these standards have not been met, nor any appropriate balance struck, by the Defendant in relation to the Project. Against this backdrop, on the basis of the information currently available to us, it appears that the Defendant has failed to discharge the fiduciary duty it owes to the Council Tax and Business Rate payers who are resident within the borough.

Best Value Duty

m. We consider that the Defendant is a "best value authority" that is subject to the best value duties specified in Section 3 of the Local Government Act 1999 (the **1999 Act**). Pursuant to Section 3(1) of the 1999 Act, the Defendant is under a duty to:

make arrangements to secure continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness.

n. The 1999 Act continues, Section 3(2) and Section 3(3), read:

[3] Charles Terrence Estates v Cornwall Council [2012] EWCA Civ 1439

(2) For the purpose of deciding how to fulfil the duty arising under subsection (1) an authority must consult-

a) representatives of persons liable to pay any tax, precept or levy to or in respect of the authority,

b) representatives of persons liable to pay non-domestic rates in respect of any area within which the authority carries out functions,

c) representatives of persons who use or are likely to use services provided by the authority, and

d) representatives of persons appearing to the authority to have an interest in any area within which the authority carries out functions.

(3) For the purposes of subsection (2) "representatives" in relation to a group of persons means persons who appear to the authority to be representative of that group.

o. On the basis of the information set out in the Cabinet decision of 27 February 2018, which reported on the extent of the consultation conducted by the Defendant it would appear that the Defendant has failed to discharge its obligations to adequately consult in relation to the discharge of its best value duty. First, we consider that the group consulted the Bournemouth and Poole Tourism Management Board (**BPTMB**), includes only a disproportionately small number of representatives of actual hotel accommodation businesses, meaning it cannot be regarded as "representative" within the meaning of Section 3(3) of the 1999 Act. Second, we note that the membership of BPTMB appears to include both Mr Bill Cotton, the Executive Director responsible for the Project and Cllr Philip Broadhead, the Leader of Bournemouth Borough Council (albeit in non-voting roles). We would question whether a body containing two of the Projects key sponsors within the Council, could reasonably act a consultative body, and be "representative" within the meaning of Section 3(3) of the 1999 Act. Third, the extent of the consultation appears to have been a relatively brief presentation on the progress of the Project. It would seem likely that the membership of the BPTMB did not contain any formal representation from the hotel sector at the point at which "consultation" took place. Fourth, and finally, it appears many of the intermediate stages of the Project were taken without consultation at all.

p. For these reasons, we conclude that the Defendant has failed to adequately discharge its obligation to consult under Section 3(2) of the 1999 Act.

Section 123 Local Government Act 1972

q. Depending on the basis on which the Defendant holds the land that forms part of the Project, it is has powers under Section 233 of the Town and Country Planning Act 1990 (as amended) or Section 123 of the Local Government Act 1972 (the **Acts**) to dispose of that land. The Acts essentially require that the local authorities achieve an outcome ("best consideration") on the disposal of their property. In order to be satisfied that the outcome as been achieved, it is common for local authorities to follow a valuation process which takes account of matters such as (amongst other things) the unencumbered value of the property on the open market. In the case of the Decisions, the Defendant provides no assurance that "best consideration" has been achieved and no assurance that any kind of valuation process has been followed. The Acts further require that, where best consideration is not going to be achieved, the local authority

seeks the consent of the Secretary of State prior to making the disposal. No reference to such consent being sought or granted is included in the Decisions.

r. We consider that the Decisions are flawed insofar that they fail to take account of Defendants obligations under those provisions. Unless the Defendant has established that it has obtained best consideration in respect of the terms of the lease, it does not have the power to approve the Project as described in the report to cabinet prepared prior to the 27 February.

10. The deficiencies identified in the public law decision making process are, individually or in combination, of sufficient severity to render Decisions unlawful.

11. To proceed without sufficient regard to the content of this letter (in particular the financial information provided by the Claimant) would further place the Defendant at risk of challenge on the basis of not having taken sufficient regard of relevant facts.

Ground 2 : State aid

12. State Aid is aid from the State (including bodies such as the Defendant) that is given to a particular undertaking or class of undertakings in a manner that distorts competition. Specifically the rules in the Treaty of the Functioning of the EU prohibit measures taken by public authorities that have all of the following features:

a. they convey an "aid", that is to say there is an economic advantage granted;

b. the aid is granted by a Member State (which include the emanations of the state such as local authorities) or through State resources;

c. the aid must distort or threaten to distort competition by favouring certain undertakings or the production of certain goods; and

d. the aid must affect trade between Member States (the test for this element is very sensitive).

13. State aid is not permitted under EU law unless an exception applies or advance permission has been sought from the European Commission through notification. We are not aware of any such exemption of relevant notification which covers the Project.

14. Our conclusion is that the market intervention proposed by the Defendant in relation to the Project amounts to State aid. In particular:

a. the provision of 100% funding of the development costs on non-market conditions amounts to the conveyance of an aid;

b. the aid (the funding) is to be provided using the Defendant's money (as borrowed from the UK State), undoubtedly involving State resources;

c. the aid (the funding) will distort competition by favouring certain undertakings. Clearly the preferred bidder will be benefitted by the provision of funding on non-market terms and, as described above result in the construction of a hotel which is not commercially viable; and

d. the aid will effect trade between Member States by virtue of the fact that Bournemouth is a nationally important holiday destination and the host of a number of international conferences.

15. Leaving aside the decision to fully fund the Project, the decision to procure a hotel scheme that is not commercially viable may, in its self, amount to an aid. On the basis of the information available, the decision to proceed with the Project is not a procurement decision that a market operator would ever take.

16. Furthermore, the proposed arrangements of the Project will transfer valuable land interests to the preferred bidder (assuming the contract is awarded). To establish whether the land transaction involves State aid analysis will be required that takes account of the European Commission guidance note "State aid elements in sales of land and buildings by public authorities".

Ground 3: procurement law issues

17. The Defendant is a contracting authority for the purposes of the procurement law derived from EU law.

18. We consider that the procurement of the Project is regulated as a services concession and therefore subject to the Treaty principles of equal treatment, non-discrimination and transparency, as set out in the Treaty of the Functioning of the European Union. It is not subject to the Concession Contracts Regulations 2016 by virtue of Regulation 66(1) thereof. Details of our views are set out below:

    a. We consider that the contractual arrangements underpinning the Project mean that it should be properly classified as a services concession contract. We note that the Defendant identifies the Project as involving the provision of services rather than works in the OJEU published in relation to the Project.

    b. As we understand the structure of the Project, the developer will perform development management services on behalf of the Defendant, and in return for performing those services, it will have the right to charge third-parties (customers of the hotel). Over the course of the term of the contract, it could be expected that this source of income would form the vast majority of the total amount received. It goes without saying that the operator of a hotel in such circumstances would carry with substantial "market risk". We would draw an analogy with a person who is contracted to manage the construction of a newspaper kiosk, which would be owned by the authority, then operate that kiosk as a business, in return for which the operator would make a concessionary payment to the contracting authority.

    c. On the assumption that this is a service concession regulated by the Treaty principles, and therefore subject to a six-year limitation period relevant to breach of statutory duty claims[4], we consider that the various changes including, the change from a private sector funded scheme and a scheme funded by the Defendant, which occurred between the First Procurement Procedure and the Second Procurement Procedure, amounts to a material change in the scope of the project. Compliance with the Defendant's obligations to conduct the procurement of services concession contracts in a transparent way requires that the procurement is terminated and re-advertised on a revised basis. In addition, the inclusion of the 10-year insurance cover at some point during the process would have made the other bidders relatively bids more attractive, giving further grounds of challenge.

[4] AG Quidnet Hounslow LLP v Mayor and Burgesses of the London Borough of Hounslow [2012] EWHC 2639

19. The foregoing is also without prejudice to any grounds of challenge that the Claimants may bring in relation to the Voluntary Ex Ante Transparency Notice issued by the Defendant in respect to the Project and published in the Official Journal of EU on 10 April 2018 (the **VEAT Notice**), which is still being considered by the Claimants. Areas of immediate concern include the extent of the change that were made following the Defendant's determination that there were "no suitable tenders" received.

F. The details of the action that the defendant is expected to take:

20. The Defendant is expected to agree not to conclude any the Development Agreement unless and until:

a. a proper legislative basis has been identified for the Project;

b. a independent review conducted by suitably experienced individuals of the financial aspects of the transaction, using verifiable comparable hotel schemes has been carried out;

c. evidence is provided to the Claimants that the Defendant has secured a 10-year rental insurance policy from a reputable insurer;

d. the Defendant has demonstrated that the arrangements in the proposed varied development agreement for the disposal of Council interests represents best consideration or have alternatively obtained the consent of the Secretary of State;

e. demonstrated to the satisfaction of the Claimants that there has been no breach of the EU Treaty principles in relation to the Project.

f. a compliant best value consultation has been conducted;

g. that the Defendant has demonstrated, with evidence, that no state aid is being granted as a consequence of the public funding that is proposed to be provided for the Project or by virtue of the proposed disposal of the Defendant's land to the developer; and in the absence of such evidence, a State aid approval has been obtained from the European Commission in relation to the land transaction and the funding mechanism for the Project.

G. The details of the legal advisors dealing with the claim:

21. All correspondence in this matter should be addressed to Mark Bassett at Dentons United Kingdom and Middle East LLP, One Fleet Place, London EC4M 7WS

H. The details of any interested parties:

22. Mill Lane Estates is an interested party. A copy of this letter has been sent to them.

23. Marick Real Estate is an interested parties. A copy of this letter has been sent to them.

I. The details of any information or documents sought:

24. Please provide the following:

a. a copy of the Savills report to which reference is made in the February 2018 Scrutiny Committee report;

b. a copy of any other Savills report relating to the scheme and in particular any advice concerning the proposed rental protection insurance for the Project;

c. evidence that the Defendant has received illustrating any other large hotel project, of a type that is comparable to the Project, that has been subject to insurance and finance on a similar basis to the Project;

d. a copy of any valuation advice from the Defendant's advisers that supports the contention that rental guarantee insurance can increase the council's interest in the underlying asset value of the Project to an amount equal to or more than its £70m cost;

e. a copy of information withheld from the public pursuant to Section 100(A)(4) of the Local Government Act 1972 in relation to Cabinet meetings that took place on 22 March 2017, 8 November 2017, and 27 February 2018, and the Corporate Service Overview and Scrutiny panel meeting that took place on 12 February 2018;

f. a copy of the transcripts of the exempt Cabinet meetings that took place on 22 March 2017, 8 November 2017, and 27 February 2018, and the Corporate Service Overview and Scrutiny panel meeting that took place on 12 February 2018;

g. details of the evaluation of the preferred bidder;

h. an un-redacted copy of the Development Agreement as agreed between preferred bidder and the Defendant; and

i. copies of the briefing provided to the BPTMB; minutes from the meeting at which the presentation was made; any attendance list; any transcription of the meeting that may have been made.

Please note that each of these items will also be the subject of a Environmental Information Regulations and/or Freedom of Information Act request.

J. Substantive issues proposed reply date:

25. We recognise that the Council will need to take advice on the issues raised in this letter. Please provide us with a response to the substantive issue **by 7 May 2018**.

Yours faithfully

Dentons

Dentons United Kingdom and Middle East LLP

CC:
Cllr Philip Broadhead (by email only to: philip.broadhead@bournemouth.gov.uk)

Cllr Donald McQueen (by email only to: donald.mcqueen@bournemouth.gov.uk)
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