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# PUBLIC PROCUREMENT LAW REVIEW

2004 Number 4 pages 153-210; NA91-NA115

Editor: Professor Sue Arrousmith  
Assistant Editor: Adrian Brown

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- The New Procurement Directives of the European Union Rhodri Williams  
The Impact of the New Procurement Directive on Large Public Infrastructure Projects: Competitive Dialogue or Better the Devil you Know? Adrian Brown  
Competitive Dialogue Steen Treumer  
Secondary Policies in Public Procurement: The Innovations of the New Directives Joel Ar mould  
Defence Procurement: The New Public Sector Directive and Beyond Martin Trybus

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Court of Justice of the European Communities	Court of Justice
Court of First Instance	In full Never C.F.I.
European Court of Human Rights	Court of Human Rights
International Court of Justice	International Court
References to EEC Treaty	<i>e.g.</i> Art.30 EEC
References to ECSC Treaty	<i>e.g.</i> Art.2 ECSC
References to EAEC Treaty	<i>e.g.</i> Art.3 Euratom

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References to the *Official Journal of the European Communities* should be as follows: [1989] O.J. L1/1. The *Review* should be cited as follows: (2004) 13 P.P.L.R.

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## Articles

# The New Procurement Directives of the European Union<sup>1</sup>

Rhodri Williams<sup>2</sup>

### 1. Introduction

In early 2004, nearly four years after the European Commission first put forward its package of amendments to simplify and modernise the public procurement regime, the European Parliament and the European Council of Ministers finally adopted two new Directives to amend and consolidate the current Directives in both the public and utilities sectors.<sup>3</sup> The Council formally endorsed the text agreed in December 2003 in a conciliation procedure<sup>4</sup> between it and the European Parliament.

The previous Directives, the oldest of which date from the 1970s were last updated in the 1990s. The package of amendments was first proposed by the European Commission in May 2000. The new regime is intended to reduce red tape, set out clearly how social and environmental criteria may be applied in awarding contracts and ensure that contracting authorities and entities and bidders can save time and money by using new technology to manage the tendering process. The new Directives were published in the Official Journal of the European Communities on (*insert date*) and will need to be implemented by the United Kingdom, along with the other Member States, within 21 months of publication.

Internal Market Commissioner Frits Bolkestein said:

“These reforms of the public procurement rules are crucial for Europe’s competitiveness. The modernisation introduced by the legislative package will help build on the already huge savings the existing directives have delivered. The package brings in simplifications and changes that those at the sharp end—contracting authorities and bidders—have asked for. Taxpayers will win twice. Electronic procurement and simpler procedures will bring administrative costs down. And more cross-border competition for contracts will cut prices.”

<sup>1</sup> For previously published articles in the *Public Procurement Law Review* on the legislative proposals put forward by the European Commission to amend the EU public procurement regime, see, (2000) 9 P.P.L.R. Issue 6; (2001) 10 P.P.L.R. Issue 10 and (2003) 12 P.P.L.R. Issue 1.

<sup>2</sup> Rhodri Williams is a barrister practising from Henderson Chambers, 2 Harcourt Buildings, Temple, who specialises in European Community law and, in particular, EU public procurement law.

<sup>3</sup> Directive 2004/00 (not yet published) on the co-ordination of procedures for the award of public supply contracts, public service contracts and public works contracts (OJEC) and Directive 2004/00 (not yet published) on the co-ordination of procurement procedures of entities operating in the water, energy, transport and postal services sectors (OJEC).

<sup>4</sup> The conciliation procedure is held in accordance with Art.251 EU. The Conciliation Committee has 30 members: 15 from the European Parliament and 15 from the Council.

The legislative package has two main objectives. The first is to simplify and clarify the existing Community Directives, and the second is to adapt them to modern administrative needs in an economic environment that is changing as a result of things such as liberalisation of telecommunications or the transition to the new economy. With the object of enhancing transparency in the award process and of combating corruption and organised crime, the legislative package also includes measures designed to make for greater clarity in the criteria determining the award of the contract and the selection of tenderers.

## 2. Simplification: making the texts clearer and more comprehensible

Simplification is an essential feature of the legislative package. The aim is to make the Directives easier to understand for everybody who is involved in public procurement, either as a buyer or as a supplier. The following examples illustrate this simplification effort:

- The three former public sector Directives, covering supplies, services and works, are consolidated and recast in a single coherent text, which has made it possible to reduce the number of articles by nearly a half.
- The new provisions are presented in a more user-friendly manner: they have been set out in such a way as to reflect the normal order of an award procedure.
- The new structure and the new provisions are designed to guide users through all the stages of the award procedure.
- The thresholds which determine the application of the new instruments are also to be simplified and will be expressed in Euros instead of special drawing rights.

## 3. Modernisation and flexibility: adapting award procedures to the needs of a modern administration and the new economy

One of the recurring demands during the consultations conducted by the Commission in preparing the proposals it put forward was the modernisation of award procedures to adapt them to the administrative requirements of the 21st century. The new proposals accordingly relax some of the provisions which were considered too inflexible to achieve the objective of best value for money. The following examples illustrate the adjustments proposed:

- For complex contracts, new procurement arrangements allow a “dialogue” between awarding authorities and tenderers to determine the contract conditions; the new procedure would offer guarantees that the principles of transparency and equal treatment would not be adversely affected by this “dialogue”. This new procedure is discussed in detail in two other articles in this issue of the *Public Procurement Law Review*.
- In order to enable administrations to benefit from economies of scale flowing from a long-term procurement policy and to guarantee security of supply and the necessary flexibility for recurring purchases, the new Directives are more flexible in the approach to standard-form contracts.
- Public-sector buyers enjoy more flexibility in defining the purpose of the contract: under the new provisions public-sector purchasers can specify their requirements in terms of performance and not only in terms of standards.

Modernisation also means adjusting procedures to an economic environment that is changing. Although the present Directives were updated in the 1990s, they date back to the 1970s. A response was therefore needed to changes resulting from things such as the information technology revolution or the liberalisation of telecommunications. The following examples illustrate this modernisation:

- The use of information technologies in public procurement is a vital factor in helping the public authorities to adapt to the changing environment and to make for more effective procurement. For this reason, the legislative package is designed to encourage the public authorities to make greater use of electronic means, for instance by shortening the time taken to publish notices or the tendering period in certain circumstances.
- As a result of liberalisation and effective competition in telecommunications, the new provisions exclude this sector from the Directive which used to apply to it.
- In anticipation of similar developments in other sectors, such as electricity or water, the legislative package provides a mechanism for excluding them once liberalisation and effective competition are a reality.

The principle aspects of importance in the new Directives are set out further below.

#### 4. Consolidation and restructuring the current Directives

The proposed Public Sector Directive consolidates the existing Directives into one single legislative text which will make reference to its provisions much easier and will result in some of the anomalies which previously existed between the different texts being eliminated.

Unfortunately, however, in some respects, the differences between the different regimes for supplies, works and services are being retained.

The new Directive also reorganises the way in which the existing material is presented so as to make reference to the provisions more “user-friendly”.

#### 5. Scope of the Directives

These issues are dealt with in Art.8 of the Public Sector Directive and Art.16 of the Utilities Directive.

First of all, the thresholds above which the provisions of each Directive apply, are to change so that all thresholds are expressed by reference to Euros, whereas currently some are expressed in SDRs (the international unit of currency referred to in the World Trade Organisation Agreement on Government Procurement (GPA)) and some are expressed in ECUs. Fortunately, this will have little effect on the actual values of the thresholds which will now be €6.242 million for works contracts and concessions and €162,000 or €249,000 for supplies and services contracts in the public sector and €499,000 for supplies and services in the utilities sector.

The current thresholds (as of January 1, 2004) in sterling are £3,236,542 for works contracts and concessions, either £99,695 or £153,376 for supplies and services contracts in the public sector and either £258,923 or £388,385 in the utilities sector.

The proposed thresholds are still set at a level which is sufficiently low to ensure that they are at least as low as those of the GPA so that any contracts caught by the latter will also be caught by the former. To ensure that this remains the case, the proposed Directive makes provision for the Commission to

adjust the thresholds in line with any future changes to the relative value of Euros and SDRs (Art.77(1) of the Public Sector Directive and Art.69(1) of the Utilities Directive).

Secondly, the current exclusion for telecommunications services from the scope of the Services Directive 92/50/EEC is to be removed (Art.18). The existing exclusion reflects the fact that such services were not previously considered suitable for procurement through competitive tendering procedures. Following the liberalisation of the telecommunications sector (leading to their exclusion from the scope of relevant activity in the utilities sector), the exclusion of the procurement of these services by contracting authorities is no longer appropriate.

## 6. Technical specifications

This issue is dealt with in Art.24 of the Public Sector Directive and Art.34 of the Utilities Directive.

Perhaps the main proposed change is to enable purchase specifications to be defined in terms of the performance to be achieved but ensuring that specifications do not create unjustified obstacles. Thus, specifications may also be formulated in terms of performance or functional requirements provided they are sufficiently precise, in addition to any mandatory standards (Art.24(3); Art.34(3)).

The provisions also make it clear that whilst European standards or national standards implementing them must be used as a means of reference to describe a product or service, a contracting authority cannot insist that the products or services required comply with the details of the standard in question. They must accept other suitable products and services, such as those that achieve the same performance criteria but by using different technology from that in the standard (Art.24(5); Art.34(5)).

The burden of showing that a tender meets performance or functional requirements lies upon the tenderer. This can be discharged by producing the technical dossier of the manufacturer or a test report of an independent third party.

## 7. Use of flexible procedures: competitive dialogue

This is dealt with mainly in Arts 29–30 and is only applicable to the public sector.

This is potentially one of the most important aspects of the proposed amendments and, by the same token, perhaps one of the most disappointing in the form currently presented. The Commission's 1998 Communication had accepted the need for greater flexibility in allowing negotiations between contracting authorities and suppliers in certain complex procurement procedures. The main features of the proposals are that the existing grounds for using the negotiated procedure with prior publication of a contract notice are to be maintained as before. Thus, for instance, the exception based on the impossibility of establishing a specification with sufficient precision, remains applicable only to services, though it is true that the exception when the nature of the contract or the risks attaching thereto do not permit overall pricing, has been extended to cover supplies as well as works and services.

The new Directive now envisages the creation of a new ground for using the negotiated procedure in circumstances which may apply to all contracts, whether for supplies, works or services. This is the exception for particularly complex contracts defined as those in which the contracting authority is not objectively able to define the technical means of satisfying its needs or objectives (Art.29(1)(a)), or is not objectively able to specify the legal and/or financial make-up of a project (Art.29(1)(b)).

Unfortunately, the existence of these conditions does not enable the contracting authority to adopt



the normal negotiated procedure with prior publication of a contract notice. Instead, an entirely new procedure is envisaged which is a version of the negotiated procedure but one subject to various additional rules (Art.29(2)–(8)).

One can immediately see that some of the express rules are even more restrictive than those which apply in ordinary competitive negotiated procedures. Furthermore, the new procedure also contains rules which would probably have applied under the existing negotiated procedure, such as a provision authorising contracting authorities to specify payments for participation (Art.29(8)), and the previously implicit rule that confidential information provided by participants should not be disclosed to third party competitors (Art.29(3)).

There is clearly considerable scope for overlap between the new exception and the current situations for using the negotiated procedure where no overall pricing is possible or where no specification is possible. Unfortunately, given the more restrictive procedural requirements for recourse to the new procedure, it is likely that the existing grounds will still be relied upon in preference to the new rules. To this extent, the extensive overlap between the various provisions detracts from the utility of the new provision.

Moreover, there is still no express provision on how to interpret the existing and proposed grounds for recourse to the negotiated procedure with prior publication of a contract notice. The ECJ has in the past ruled that the exceptions are to be construed restrictively and that the burden lies on the contracting authority seeking to rely on the same. It is not clear whether this approach should be applied in relation to the new provisions. Contact with the Commission has shown that it takes the view that it does. If this is correct, it will further detract from the attractiveness of using such a procedure.

As noted above, the competitive dialogue procedure is analysed in more detail in two articles in this same issue of the *Public Procurement Law Review*.

## 8. Framework agreements

This issue is dealt with in Art.32 of the Public Sector Directive. For utilities, provisions on the subject already exist as Art.14 of the Utilities Directive.

This introduces for the first time explicit provisions on the use of framework agreements (defined in Art.1(5)) and will have various effects on the current regime. They involve the authorisation of certain types of framework which are not permitted at present and set out an express procedure for the operation of such framework agreements. This is the case where the agreement involves suppliers submitting new or amended tenders in a competition for a specific order. The new provision allows this, provided that certain conditions are complied with and these include allowing sufficient time-limits for tenderers (Art.32(4)(b)), selecting the supplier on the basis of the previously stated award criteria (Art.32(4)(d)), the obligation on the contracting authority to consult with all framework suppliers (Art.32(4)(a)) and the requirement that tenders should be confidential until the deadline (Art.32(4)(c)).

Controls are introduced over such framework agreements, such as a rule that they may not exceed four years save in exceptional duly justified cases (Art.32(2)). The provision also sets out details of the contents of notices to be used for framework agreements.

It is also provided that contracting authorities may not use framework agreements improperly or in such a way as to restrict or distort competition (Art.32(2)). Finally, the provision sets out details for the

use of framework agreements, such as that it is not necessary to publish a contract notice for every contract awarded under a framework agreement but only a notice of the selection of the framework suppliers (Art.35(2)), and specific rules on aggregation (Art.9(9)).

## 9. Electronic procurement: dynamic purchasing systems

This subject is dealt with in Art.33 of the Public Sector Directive and Art.15 of the Utilities Directive. The provisions are part and parcel of the new provisions dealing with electronic procurement. The Commission has previously given great emphasis to the importance of facilitating and promoting electronic procurement and the proposed amendments include a number of proposals towards this end.

A dynamic purchasing system is defined (in Art.1(6) and Art.1(5)) as a completely electronic process for making commonly used purchases, the characteristics of which meet the requirements of the contracting authority, which is limited in duration and open throughout its validity to any economic operator which satisfies the selection criteria and has submitted an indicative tender that complies with the specification.

The new provisions now allow contracting authorities and entities to use these systems by publishing a contract notice, indicating the specification of the purchases envisaged and offering, by electronic means, unrestricted direct and full access to the specification.

## 10. Electronic procurement: time-limits

This subject is dealt with in Art.38 of the Public Sector Directive and Art.45 of the Utilities Directive.

It is also provided that the minimum time-limits may be reduced to take account of the use of electronic means and to provide an incentive for using these new means. Thus, it is proposed that the time-limits for tendering in open procedures and submission of requests to participate in other procedures be reduced by seven days and where the contracting authority offers free direct access by electronic means to the contract documentation, the periods may be further reduced by five days (Art.38(5)(6); Art.45(5)(6)).

Further, it is made clear that contracting authorities can require the use of electronic means for communications and for accessing documents, if they so wish (Arts 39–42; Arts 46–48). There is then one connected provision (at Art.42(3); Art.48(3)) which states that the content of tenders should be confidentially examined only after the expiry of the deadline for submission.

## 11. Selection criteria

This subject is dealt with in Arts 44–52 of the Public Sector Directive; Arts 51–54 of the Utilities Directive.

This provision covers the criteria used for selecting parties to tender or negotiate in the restricted and negotiated procedures. The most important aspect is that a provision is introduced that a bidder may be excluded from participation only on the basis of the selection criteria and/or levels of capacity and experience that have been set out in the contract notice (Art.44(4) of the Public Sector Directive).

Further, there is a new provision requiring contracting authorities to exclude from contracts, bidders which have, in the previous five years, been convicted of a serious offence in connection with

organised crime, of corruption in public contracts or of fraud relating to the European Communities (Art.45(1)(a)–(d)).

## 12. Award criteria

This subject is dealt with in Art.53 of the Public Sector Directive and Art.55 of the Utilities Directive.

This Article introduces a new provision which will require contracting authorities to specify in advance the relative weighting to be given to award criteria when the award is based upon the most economically advantageous tender (Art.53(2); Art.55(2)). Henceforth, this is normally to be stated in the contract notice but may, in exceptional and duly justified cases, be stated in the invitation to tender/negotiate in restricted and negotiated procedures.

## 13. Use of electronic auctions

This subject is dealt with in Art.54 of the Public Sector Directive and Art.56 of the Utilities Directive.

An electronic auction is defined (Art.1(7); Art.1(6)) as a repetitive process involving an electronic device for the presentation of new prices, revised downwards, and/or new values concerning certain elements of tenders, enabling them to be ranked using automatic evaluation methods.

Such auctions are now explicitly introduced to the EU public procurement regime for the first time.

## 14. Use of the Common Procurement Vocabulary (CPV)

Various provisions of the Directives currently in force, such as those dealing with the categories of services falling within the full and partial regimes of the Services Directive and the scope of services falling within the concept of works for the Works Directive, use different nomenclature systems to describe the works, products and services to which they apply. The CPC, CPA and NACE are all referred to at some point in the texts of the current Directives. The Directives now substitute references to the EU's own Common Procurement Vocabulary (CPV) for all these existing references. This is not intended to alter the scope of the various provisions affected, but simply to provide a new and uniform form of reference. It is, of course already the case, that since the coming into force of EC Regulation 2195/2002<sup>5</sup> on the Common Procurement Vocabulary (CPV) on December, 16, 2003, the single classification system of the CPV has been obligatory for identification and classification purposes within the notices published in the Official Journal.

## 15. Conclusion

The long awaited adoption of these two consolidating Directives is to be welcomed. How the new regime will function in practice will only be seen once the Directives are implemented into national legislation within the next 21 months. In respect of the new Utilities Directive, under Art.71, there is also provision for the application of the legislation to be postponed in the Member States for a further period after implementation, expiring no later than January 1, 2009.

<sup>5</sup> EC Regulation 2195/2002 of the European Parliament and of the Council of November 5, 2002; [2002] O.J. L340/1.

# The Impact of the New Procurement Directive on Large Public Infrastructure Projects: Competitive Dialogue or Better the Devil you Know?

Adrian Brown

*Herbert Smith, Brussels*

## 1. Introduction

After years of deliberation, the new Directive on public procurement was finally adopted by the European Union on February 2, 2003.<sup>1</sup> EU Member States have been given until 21 months from the date of publication (which was expected in late March or early April 2004) to implement the changes introduced by this Directive. The purpose of the current article is to examine the likely impact of the new Directive on the procedures used by public sector authorities for awarding large infrastructure contracts, such as public private partnerships (PPPs) and projects under the UK Government's Private Finance Initiative (PFI).<sup>2</sup> Such projects extend across a wide range of vital sectors and facilities, including hospitals, schools, prisons, roads, bridges, tunnels, information technology (IT) and accommodation.

Under the new Directive, there are two areas of change that are of particular relevance to large infrastructure projects:

- First, the Directive includes certain clarifications regarding the competitive negotiated procedure, which is the award procedure that is currently used for most major, PFI-type projects.
- Second, the new Directive introduces an entirely new award procedure, called the "competitive dialogue", which appears to be particularly aimed at complex, large-scale projects.

This article will examine these changes in detail. In particular, it will assess the degree of flexibility that is permitted under each procedure and will consider whether awarding authorities are likely to make use of the new competitive dialogue procedure. For the reasons discussed in depth below, the

<sup>1</sup> Directive 2004/[ ]/EC of the European Parliament and of the Council on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts [no. & OJ ref]. For convenience, Directive 2004/[ ] will often be referred to as the "new" Directive in this article, while its predecessors, namely Services Directive 92/50, Supplies Directive 93/36 and Works Directive 93/37, will be referred to collectively as the "old" Directives. On the same day, the Council also adopted Directive 2004/[ ]/EC applicable to utilities in the fields of water, energy, transport and postal services. The latter Directive does not include a competitive dialogue procedure and is not considered further in this article.

<sup>2</sup> The term public-private partnership (PPP) is a generic one used to describe a broad range of projects involving both the public and private sectors. A recurring feature is that the private sector bears a substantial part of the financing and risks associated with the project. PPPs have become an increasingly common way of realising large infrastructure, construction or service-related projects across Europe. The UK has been a frontrunner in developing PPPs under the Private Finance Initiative (PFI), which was first launched in 1992 and has been continued under successive governments.

overall conclusion is that authorities are likely to be reticent about using that new procedure and may well prefer to continue the current practice of using a competitive negotiated procedure.

The article will not examine other changes introduced by the new Directive. It is sufficient to note that the Directive introduces some significant adjustments and clarifications of existing procedural requirements. These include: express confirmation that service concessions fall outside the scope of the Directive<sup>3</sup>; an obligation to exclude any candidates who have been convicted for organised crime, corruption fraud or money laundering<sup>4</sup>; a new requirement to specify the relative weighting of award criteria; and confirmation that authorities may apply environmental award criteria. The new Directive also provides for several new types of award procedure besides competitive dialogue: namely, framework agreements, “dynamic purchasing” and electronic auctions. These three new procedures are potentially relevant to regular or repetitive contracts for goods or services but are not generally suitable for large infrastructure contracts.

## 2. Lack of flexibility under open and restricted procedures

It is widely accepted by those involved in public infrastructure projects that any award procedure requires a high degree of flexibility and a need for dialogue, ultimately including negotiation, between the public sector body and the parties bidding to become the private sector partner. This necessity arises from the sheer size and complexity of such projects. It also reflects the philosophy underlying PPPs, particularly under the UK’s Private Finance Initiative, which is that public authorities should not dictate detailed specifications and solutions in advance, but should instead look to private sector entities to put forward their own ideas on how the authority’s very broadly stated requirements should be met.

Both the old and new procurement Directives point public authorities towards use of the open procedure or restricted procedure.<sup>5</sup> These two procedures are available in all cases, whereas the competitive negotiated procedure and the new competitive dialogue are only available in certain limited circumstances (as explained below). However, the problem with both the open and restricted procedures is that they presuppose that the authority will already be able to describe precisely what it requires at the outset, so that the private sector bidders can simply submit written tenders responding to those specifications, leaving the authority to make a choice based only on those written tenders. The inflexibility of these procedures is highlighted by a joint statement, issued by the Council and the Commission upon adoption of Directive 93/37/EEC, which declared that:

“In open and restricted procedures all negotiations with candidates or tenderers on fundamental aspects of contracts, variations in which are likely to distort competition, and in particular on prices, shall be ruled out; however, discussions with candidates or tenderers may be held but only for the purposes of clarifying or supplementing the content of their tenders or the requirements of the contracting authorities and provided this does not involve discrimination.”<sup>6</sup>

<sup>3</sup> Confirming the ruling of the European Court of Justice in *Teleaustria*. Services concessions arise where the private sector provider bears a significant part of the risk associated with providing the service and derives at least part of its revenue directly from end users. Large infrastructure projects, such as all toll bridges and roads, are more likely to be works concessions, which are still regulated by the Directive.

<sup>4</sup> Member States are left to define the implementing provisions for this new rule.

<sup>5</sup> Under the open procedure, the authority’s initial *Official Journal* notice calls for tenders directly from any interested parties.

Under a restricted procedure, the authority invites requests to participate and then invites a shortlist to submit tenders.

<sup>6</sup> Statement concerning Art.7(4) of Council Directive 93/37/EEC of June 14, 1993, [1994] O.J. L111/114.

Consequently, the scope for any meaningful discussion or negotiation between the authority and tenderers appears to be very limited under open and restricted procedures.<sup>7</sup> In reality, an authority awarding an infrastructure project will wish to discuss and negotiate upon the proposals put forward by the bidders before inviting a final round of best offers, otherwise, the tenders may well not respond fully to the authority's requirements and/or may prove unaffordable.

It can be concluded that the open and restricted procedures will generally be unsuitable for large infrastructure projects. To date, the solution in practice has been for awarding authorities to use the competitive negotiated procedure instead. Sections 3 to 5 below examine the competitive negotiated procedure in detail. The competitive dialogue procedure, introduced by the new Directive, is then assessed in sections 6 to 8. A final section 9 draws conclusions on the comparative merits of the two procedures.

### 3. Availability of the competitive negotiated procedure

#### 3.1 The relevant grounds for using a competitive negotiated procedure

The rules governing the availability of a competitive negotiated procedure have not materially changed. Under both the new Directive and its predecessors, whereas the open and restricted procedures are available in all cases, a competitive negotiated procedure may be used by public authorities only on certain limited grounds. The wording of those grounds remains essentially unchanged. Two of these grounds are potentially relevant for large infrastructure contracts:

- (i) "in exceptional cases, when the nature of the works, supplies, or services or the risks attaching thereto do not permit prior overall pricing;"<sup>8</sup>
- (ii) "in the case of services. . . the nature of the services to be provided is such that contract specifications cannot be established with sufficient precision to permit the award of the contract by selection of the best tender according to the rules governing open or restricted procedures."<sup>9</sup>

To date, authorities proposing to enter into a PPP or PFI project have usually relied on one or other of these two grounds in order to justify recourse to the competitive negotiated procedure. The first ground, although stated to be limited to "exceptional cases", can be argued to apply on the basis that the precise scope of a PPP's subject-matter is uncertain at the outset, as is the risk allocation between the public and private sector parties, making "prior overall pricing" difficult if not impossible. The second ground above is only available where the PPP can be categorised as a services contract. It may be argued to apply if the scope of the services to be provided under a PPP is uncertain at the outset, for example because the authority is waiting to receive ideas from the private sector, implying that specifications cannot be prescribed with "sufficient precision" at the outset.

<sup>7</sup> At s.2.1.2.2 of its 1998 Communication on public procurement, the Commission itself recognised that "the standard procedures in the (public sector) Directives leave very little scope for discussion during the award of contracts and therefore regarded as lacking in flexibility".

<sup>8</sup> Article 30.1(b) of new Directive [ ], which is equivalent to Art.11.2(b) of the Services Directive 92/50 and Art.7.2(c) of Works Directive 93/37. No such ground was previously available for supply contracts under the Supplies Directive 93/36. The extension of this ground to cover supplies contracts will rarely be relevant to PPPs, as PPPs are hardly ever categorised as a supplies contracts.

<sup>9</sup> Article 30.1(c) of new Directive [ ], which is almost identical to Art.11.2(c) of Services Directive 92/50. No equivalent provision exists for works or supplies contracts.

As discussed below, the validity of the above arguments has yet to be tested in any case law before the European Court of Justice, although they appear to have been endorsed in one British judgment.

### 3.2 Guidelines and case law

The grounds for using a competitive negotiated procedure have not yet been the subject of any judgment by the European Court of Justice.<sup>10</sup> In July 2000, the European Commission took the first step towards bringing such a case when it announced that it had sent reasoned opinions to the UK Government objecting to the use of competitive negotiated procedures in relation to two projects.<sup>11</sup> However, those two procedures were subsequently dropped without recourse to court action.

The UK Government has generally advocated use of competitive negotiated procedures for PPPs and PFI projects. HM Treasury guidelines have stated that, “a competitive negotiated procedure is already permitted by the Directives in certain clearly defined circumstances which are very likely to apply to PFI projects.”<sup>12</sup>

The approach of HM Treasury has been endorsed in the one High Court ruling to date on the issue. The *Kathro* case<sup>13</sup> concerned a judicial review action against a local council by local residents who were seeking to stop a PFI project for two new schools and a sports centre. One argument raised by the complainants was that the council was not entitled to use a competitive negotiated procedure. The judge ruled that, “it was properly open to the defendant to use the negotiated procedure”. The basis for that view is stated only very briefly and without reference to the wording of the two specific grounds cited above.<sup>14</sup> The judge simply mentions that he took into account the Treasury guidance, the “complex characteristics” of the PFI scheme in question and “the impracticability of any procedure other than the negotiated procedure”.

In practice, therefore, it appears that there is relatively little risk of any formal complaint or legal action arising in respect of use of a competitive negotiated procedure for PPPs, as evidenced by the fact that there has not yet been a single successful action on this basis. Most firms bidding for a large

<sup>10</sup> There have been over a dozen ECJ rulings concerning use of a *non-competitive* negotiated procedure (*i.e.* one without publication of a contract notice). The non-competitive version is available only in very narrow circumstances, such as where only one bidder is technically capable of performing the contract or where there is extreme urgency due to external factors. The Court has consistently stressed that the grounds for a non-competitive negotiated procedure must be interpreted strictly and that the awarding authority bears the burden of proof. It is debatable whether that strict interpretation applies equally to the grounds for a *competitive* negotiated procedure. The fact that, in the new Directive, the competitive and non-competitive negotiated procedures are each given their own separate Article (Arts 30 and 31 respectively) should increase the scope for arguing that these are two distinct types of procedure which may be treated differently. Given that the circumstances justifying a non-competitive negotiated procedure will rarely apply to PPPs, this version of the negotiated procedure is not considered further in this article.

<sup>11</sup> Re-development of Pimlico School, London, and provision of community facilities in Ipswich. Commission press release IP/00/869 of July 27, 2000.

<sup>12</sup> Technical Note No.2, “How to Follow EC Procurement Procedure and Advertise in the OJEC”, Treasury Taskforce, June 1998. The website of HM Treasury states that these guidelines are still valid.

<sup>13</sup> R. (*on the application of Kathro*) v *Rhondda Cynon Taff County BC* [2001] EWHC Admin 4527, judgment of Richards Judge of July 6, 2001.

<sup>14</sup> The brevity of the judge’s consideration of this issue can be explained by his following comments at para.[77] of the judgment:

“In any event I have strong doubts about the claimants’ standing to raise this issue. . . The correct procedure is a matter of obvious concern to tenderers or would-be tenderers, but those persons have their own remedies under the regulations themselves. The claimants have not been shown to be affected in any way by the choice of tendering procedure. They have seized on the point simply as a fall-back way of trying to stop the project.”

The issue would probably have been considered in much greater detail if the challenge had been brought by an actual or potential tenderer, rather than local residents.

infrastructure contract accept the need for flexibility and negotiation and are therefore unlikely to bring an action against an authority solely on the ground that it should not have used the competitive negotiated procedure. The Commission also appears reluctant to pursue such objections, at least in the continued absence of complaints from affected parties. As explained later in this article, the continued availability of the competitive negotiated procedure casts doubt on the extent to which authorities will switch to using the new competitive dialogue procedure when awarding large infrastructure contracts such as PPPs or PFI projects.

## 4. The process to be followed under a competitive negotiated procedure

### 4.1 Typical conduct of a competitive negotiated procedure

The new Directive briefly defines negotiated procedures as “those procedures whereby the contracting authorities consult the economic operators of their choice and negotiate the terms of the contracts with one or more of them.”<sup>15</sup> This concise definition is essentially the same as that found in the old public sector Directives.

The old Directives did not set out any further clarification on precisely how the awarding authority may conduct the competitive negotiated procedure. Authorities were (and remain) obliged to undertake several minimum steps that are also found in a restricted procedure: principally, publication of a notice advertising the contract in the EU *Official Journal*; pre-qualification and short-listing of candidates (minimum number: three) by reference to their financial and technical capabilities; and award of the contract to the most economically advantageous offer in accordance with pre-stated award criteria. Apart from the need to respect these procedural milestones, together with the overriding principle of equal treatment, many authorities have considered themselves free to conduct the negotiated procedure largely as they see fit in accordance with good commercial practice.

In practice, a competitive negotiated procedure will typically include (*inter alia*) the following phases:

- Informal consultation of private sector parties before publication of a notice in the EU Official Journal;
- After selection of the shortlist of candidates, several rounds of negotiation interspersed with one or more rounds of formal written tenders, with certain shortlisted candidates being eliminated at different stages;
- As a final competitive stage, the authority may invite “Best and Final Offers” (BAFOs) from the two or more candidates still in the process;
- After selection of the preferred bidder, a final period of negotiation and clarification occurs with that bidder alone, in order to finalise details of the project and relevant contract terms and conditions.

Although the above stages have all become common practice in procedures for the award of PPPs, none of them were expressly provided for or authorised in the old procurement Directives. The new Directive, however, does introduce some limited guidance on what should or may occur in a competitive negotiated procedure, as discussed below.

<sup>15</sup> This definition covers both non-competitive and competitive negotiated procedures (see n.10 above).



#### 4.2 Clarifications introduced by the new Directive

The new Directive lays down, at Arts 30(2) to 30(4), several clarifications regarding conduct of a competitive negotiated procedure. First, Art.30(2) states that:

“contracting authorities shall negotiate with tenderers the tenders submitted by them in order to adapt them to the requirements which they have set out in the contract notice, the specifications and the additional documents, if any, and to seek the best tender in accordance with Article 53(1).”

The above provision does not shed much new light on the process. It indicates that one purpose of the negotiations is to adapt tenders to the authority’s requirements, without making it clear whether other objectives may also be pursued. For example, it is not clear whether the adaptation process may also operate in the opposite direction, with authorities being able to adjust their requirements (within reasonable limits) in order to reflect the solutions which emerge as workable and affordable during the negotiation process.

Second, Art.30(3) of the new Directive provides that:

“During the negotiations, contracting authorities shall ensure the equal treatment of all tenderers. In particular, they shall not provide information in a discriminatory manner which may give some tenderers an advantage over others.”

This statement confirms that the negotiations process must respect the overriding general principle of equal treatment. In particular, authorities must be even-handed when providing information to tenderers. Such a requirement is already implicit from the case law relating to other types of award procedure.

Finally, Art.30(4) states that:

“Contracting authorities may provide for the negotiated procedure to take place in successive stages in order to reduce the number of tenders to be negotiated by applying the award criteria in the contract notice or the specifications. The contract notice or specifications shall indicate whether recourse has been had to this option.”

This statement provides the most useful clarification. It removes lingering uncertainty over the permissibility of following a staged process, under which the number of bidders is progressively reduced. For example, an authority may wish to open the negotiations phase with four bidders but then ultimately reduce that number to two for the purpose of inviting Best and Final Offers. Such a “staggered” process may produce the best results. It has the advantage of creating sufficient competitive tension at the start of the process, while recognising that the resources of both the authority and the bidders are used more efficiently if detailed final bids are submitted only by a reduced number of tenderers.

The above Art.30(4) has to be read in conjunction with Art.44(4). The latter provision re-iterates that any early elimination of tenders in a competitive negotiated procedure<sup>16</sup> must be made on the

<sup>16</sup> As explained below in section 8.3 below, Art.44(4) also applies to the elimination of solutions in a competitive dialogue procedure.

basis of the authority's stated award criteria. It adds that "in the final stage, the number arrived at shall make for genuine competition in so far as there are there are enough solutions or suitable candidates." It is to be hoped that this provision will be interpreted flexibly so as to allow the final number to be as low as two. Article 44(3) allows the number invited to negotiate at the outset to be as low as three, suggesting that it would not be unreasonable for that number to decrease to two pursuant to a staged procedure under Art.30(4). Experience has shown that two will often be the optimum number for the final stage of Best and Final Offers. Given the very high cost of submitting detailed final bids, limiting the number of bidders to two often promotes the most effective competition, by giving those two bidders a realistic prospect of success and hence the greatest incentive to commit their resources to producing a comprehensive and high-quality tender.

Finally, it should be noted that, if an authority wishes to conduct the competitive negotiated procedure in successive stages, Art.30(4) obliges it to state this intention upfront, either in the *Official Journal* notice or the contract specifications. This is a new express requirement, although it was already good practice (and in accordance with the principle of transparency) for authorities to set out their intended process clearly at the outset.

## 5. Post-tender negotiations in a competitive negotiated procedure

### 5.1 The need for post-tender negotiations

As mentioned in section 4.1 above, it is standard practice, and indeed unavoidable, for an authority awarding a major infrastructure project, such as a PPP, to hold a final negotiation stage with the preferred bidder alone, between contract award and contract signature. The reasons for this are well explained in Jordans' *PFI Handbook*, as follows:

"From the awarding authority's point of view, it would be ideal if a competitive environment could be maintained through to contract signature and/or financial close. The commercial reality, however, is that a tenderer (and its debt funders) will only be prepared to commit the substantial resources to bring a project to commercial and financial close after that tenderer has been selected as the preferred bidder. Debt funders, in particular, will not be prepared to incur the costs of carrying out a due diligence exercise while the tenderer they are backing is still in the process of competing for the project. In practice, therefore, an awarding authority can expect to engage in potentially lengthy tripartite negotiations with the preferred tenderer and the debt funders, before a project can be brought to financial close."<sup>17</sup>

During this post-award phase, the authority will need to verify the "deliverability" of the winning tenderer's proposals and its commitment to the terms of its bid. The authority will wish to limit the scope for the preferred tenderer to re-open issues that had been settled during the competitive phase, particularly if that would involve a price increase, but some changes in price, time frame or risk-allocation may prove inevitable in order to secure a final agreement. In some cases, the authority will appoint a "reserve" preferred tenderer (the tenderer that offered the second most economically advantageous tender), in order to maintain some competitive pressure on the preferred tenderer.

<sup>17</sup> Jason Fox and Nicholas Tott, *The PFI Handbook* (Jordans), para.5.7.8.

## 5.2 Are post-tender negotiations permitted under the EU procurement rules?

The extent to which post-tender negotiations are permissible under EU procurement rules is a recurring issue. A concern arises in principle because, once a bidder has been selected on the basis that it offered the most economically advantageous tender, it would potentially be unfair to other bidders (and contrary to the principle of equal treatment) if the winning bidder could then significantly alter the terms of its tender. Perhaps surprisingly, however, neither the old procurement Directives nor the new Directive lay down any express provisions regarding post-tender negotiations in a competitive negotiated procedure, although it will be explained in section 8.5 below that the new Directive does introduce some provisions regarding post-tender “clarifications” under the new competitive dialogue procedure.<sup>18</sup>

### 5.2.1 *The ruling of the European Court of Justice in the Rennes case*

To date, the issue has rarely arisen in case law.<sup>19</sup> Some indication of the approach of the European Court of Justice may be gleaned from Case C-337/98 *Commission v France*. That case concerned a protracted (non-competitive) negotiated procedure for the award of a contract for an urban light railway in Rennes. The procedure had begun before entry into force of the relevant Directive in 1993 but was completed several years after that date. The European Commission claimed that the French awarding authority in effect commenced a new procedure when it re-negotiated certain aspects of the proposed contract in 1996. The Court considered that the relevant question was:

“whether the negotiations opened after...1995 were substantially different in character from those already conducted and were, therefore, such as to demonstrate the intention of the parties to re-negotiate essential terms of the contract.”

The Court decided on the facts of the case that there was no such intention. It stated that, in a protracted negotiated procedure, the parties may take into account technological developments which take place while the negotiations are underway, without that being regarded each time as re-negotiation of essential terms. Equally, the Court noted that an increase in the contract price was the result of the application of a formula for the revision of prices that had been agreed earlier in the process. It was therefore an indication of the continuity of the negotiated procedure, rather than evidence that an essential term of the contract had been re-negotiated.

Although the Court made these findings in the context of determining when a (non-competitive) negotiated procedure should be deemed to have commenced, the Court may well apply a similar reasoning when assessing the permissibility of changes to contract terms during a competitive negotiated procedure. Hence, the relevant test is likely to include consideration of whether the post-tender negotiations are “substantially different” from earlier negotiations and whether they are aimed at, or result in, the re-negotiation of “essential terms” of the contract.

<sup>18</sup> In relation to open and restricted procedures, see the notice cited in section 2 above, which forbids negotiations at any stage of these two procedures.

<sup>19</sup> In Case C-87/94 *Commission v Belgium* (the “Walloon buses” case), the European Court of Justice ruled that a Belgian transport authority had breached the principle of equal treatment by permitting post-tender amendments by one tenderer and derogating unilaterally from its specifications in favour of that tenderer. However, this infringement occurred in the context of an open procedure.

### 5.2.2 Commission decision in relation to the London Underground PPP

The most detailed and helpful authority to date has been the European Commission's state aid decision in 2002 in relation to the London Underground PPP.<sup>20</sup> The author's in-depth review of that important decision was set out in an earlier issue of the *Public Procurement Law Review*.<sup>21</sup> In summary, the Commission's decision examined, as part of a state aid assessment, whether certain post-selection modifications to the London Underground PPP contracts involved unfair discrimination and amounted to a breach of the procurement rules. Those modifications were made after preferred bidders had been selected, in the context of a protracted and complex competitive negotiated procedure. They included changes in the timing and scope of the work to be done, in the performance regime and methods of performance measurement, in risk allocation and in contractual provisions on funding. The Commission carried out a detailed assessment of the scale and effect of those various post-selection changes before ultimately concluding that there had been no infringement. The Commission noted that the negotiated procedure is "flexible by its nature" and that "this type of infrastructure project requires a flexible approach." It therefore recognised that:

"in a complex and innovative infrastructure contract of this type, using the negotiated procedure . . . negotiations with single preferred bidders [were] an unavoidable part of the process of finalising a market price for the contracts."

On the complex facts of the case, the Commission concluded that the modifications in question did not change the scope of the project beyond that which was contemplated by the *Official Journal* notice and were not unfair to bidders excluded earlier in the process, particularly as the possibility of post-selection changes had been made known to all bidders in advance. The Commission also took into account the fact that many of the changes were necessitated by external or objective factors, such as evolving cost constraints and revised demand forecasts.

### 5.2.3 Commission decision on the Thessaloniki metro

The Commission took a similarly flexible approach when deciding in 2003 to dismiss a complaint concerning the award of a major contract for construction of a new underground metro system in Thessaloniki, Greece.<sup>22</sup> The complaint alleged, *inter alia*, that post-tender changes negotiated with the preferred bidder had breached the principle of equal treatment. The Commission dismissed this, stating in its press release of April 30, 2003 that:

"Any successful bidder for the contract could have negotiated the final contract on similar terms, without incompatibility of the tender documents, which left a wide margin of interpretation with regard to clauses that could be negotiated by the preferred bidder."

One issue had concerned the defined depth of tunnels, which was different in the final contract from that set out in the tender documents. The Commission did not consider this to constitute an

<sup>20</sup> State aid Decision No. 264/2002. The full 52-page text of the Decision is available on the DG COMP website: [www.europa.eu.int/comm/dgs/competition](http://www.europa.eu.int/comm/dgs/competition).

<sup>21</sup> A. Brown and C. Goulinopoulos, "The permissibility of post-selection modifications in a tendering procedure: decision by the European Commission that the London Underground Public-Private Partnership does not involve State aid, October 2, 2002" (2003) 3 P.P.L.R. NA47.

<sup>22</sup> Commission press release IP/03/2003 of April 30, 2003. See the author's note on this decision at (2003) P.P.L.R.

unacceptable modification, given that the tender documents specifically foresaw the possibility of such amendments.

### 5.3 Conclusion regarding post-tender negotiations

It can be seen from the above decisions that, at least in relation to large infrastructure projects, the European Commission has accepted the need for post-tender negotiations with the preferred tenderer in a negotiated procedure and that these may result in some modifications to the tender or resulting contract. It remains to be seen whether the European Court of Justice or a national court would take a similarly flexible view. The *Rennes* case referred to above suggests that the Court of Justice may well do so. Besides the matters referred to in that ruling, the Court is likely to consider whether the post-tender changes were reasonable in scope and whether they discriminated in favour of the preferred bidder.

## 6. The new competitive dialogue procedure: background

In its 1998 Communication on Public Procurement, the Commission recognised that there was a need for greater flexibility in the Directives' tendering procedures, at least for certain complex contracts.<sup>23</sup> In an attempt to inject such flexibility, the Commission's original proposal of May 2000 included a type of competitive dialogue procedure, although it was not, at that stage, given its own name and was instead listed as a new type of competitive negotiated procedure.<sup>24</sup> This procedure ultimately evolved into the distinct "competitive dialogue" procedure, as laid down in Art.29 of the new Directive.

Essentially, this new procedure is intended to allow authorities to hold discussions with shortlisted candidates regarding the authority's requirements, before the authority invites final written tenders. The purpose underlying the new procedure is summed up in Recital 29 to the Directive as follows:

"a flexible approach should be provided which preserves not only competition between operators but also the need for the contracting authorities to discuss all aspects of the contract with each candidate."

The procedural steps envisaged under this new procedure are described in section 8 below. First, however, it is appropriate to explain the limited circumstances in which the procedure will be available.

<sup>23</sup> Commission Communication: Public Procurement in the European Union, March 11, 1998. Section 2.1.2.2, headed "Facilitating dialogue", stated that:

"especially in the case of particularly complex contracts in areas that are constantly changing, such as high technology, purchasers are well aware of their needs but do not know in advance what is the best technical solution for satisfying those needs. Discussion of the contract and dialogue between purchasers and suppliers are therefore necessary in such cases. But the standard procedures in the "traditional" Directives leave very little scope for discussion during the award of contracts and are therefore regarded as lacking in flexibility in situations of this type. The Commission will therefore propose amendments to the existing texts of the Directives with a view to making procedures more flexible and allowing dialogue in the course of such procedures and not just in exceptional circumstances."

<sup>24</sup> For a critique of this aspect of the original proposal, see Arrowsmith at (2001) 1 P.P.L.R. NA129 to 131.

## 7. Competitive dialogue permitted only for “particularly complex” contracts

### 7.1 The definition of “particularly complex”

The Commission’s 1998 Communication had envisaged that the new competitive dialogue procedure would be a new “standard” procedure alongside the open and restricted procedures and would not be confined to exceptional circumstances. However, the Commission ultimately decided to insert strict limits on the procedure’s availability. Article 29(1) of the new Directive specifies that:

“In the case of particularly complex contracts, Member States may provide that where contracting authorities consider that the use of the open or restricted procedure will not allow the award of the contract, the latter may make use of the competitive dialogue in accordance with this Article.”

Hence, the competitive dialogue procedure is not available in all cases but is confined to “particularly complex contracts.” The definitions section of the Directive (Art.1.11) expands on this point by stating that, for the purpose of recourse to this procedure:

“a public contract is considered to be “particularly complex” where the contracting authorities

- are not objectively able to define the technical means in accordance with Article 23(3)(b), (c) or (d), capable of satisfying their needs or objectives, and/or
- are not objectively able to specify the legal and/or financial make-up of a project.”

The above definitions lack clarity and it is difficult to know precisely what they are intended to cover. The first limb refers to an inability to define the “technical means” for meeting the authority’s needs. This rather nebulous term is not defined but may be interpreted as referring to the skills, knowledge, technology or methods capable of realising the authority’s overall objective. For example, an authority wishing to enter into a PPP for a major road or rail tunnel under a river may not know which types of tunnel technology or construction method are safe or feasible, given the locality’s geological features. Such a situation could be argued to fall within the first limb of the above definition of “particularly complex.” The cited sub-*paras* of Art.23 allow an authority to lay down technical specifications (*inter alia*) “in terms of performance or functional requirements”, suggesting that this limb does extend beyond purely technological difficulties to more general problems in predetermining the project’s “output specifications”.

The second limb of the definition of “particularly complex” is equally unclear. The term “legal and/or financial make-up” is not defined and is potentially very open-ended. One can only speculate that it refers to difficulties in pre-determining matters such as the contractual structure of the arrangement (*e.g.* joint venture versus a long-term partnering contract), the underlying contract terms and conditions, and the arrangements for funding the project. At the start of any major project there is usually some uncertainty regarding all of these legal and financial matters, so it is not clear where the line should be drawn when determining whether a contract is sufficiently “complex”.

Under both limbs of the definition, it is also unclear precisely what the term “*not objectively able*” means. Article 29(1) states that a competitive dialogue is permitted “*where contracting authorities consider that use of the open or restricted procedure will not allow the award of the contract*” (emphasis added), suggesting a degree of subjectivity and discretion on the part of the authority. However, the insertion of the word “objectively” in the definition of “particularly complex” suggests that some

form of reasonableness standard may be applied to the authority's inability to define in advance the technical, financial or legal matters in question. A court may therefore consider it appropriate to assess whether a reasonably diligent authority *ought* to have been capable of pre-defining those matters.

It is submitted, however, that a court should also take into account the actual level of experience and expertise in fact held by the particular authority in relation to the type of contract being awarded. For example, a court should allow greater flexibility where the authority is awarding a large PFI contract for the first time. By contrast, a stricter approach may be justified where the contract is a virtual re-run of a very similar contract that the same authority awarded within the previous few years.

## 7.2 Clarification given by Recital 29

Recital 29 to the Directive purports to clarify the intended scope of the phrase "particularly complex", as follows:

"Contracting authorities which carry out particularly complex projects may, without this being due to any fault on their part, find it objectively impossible to define the means of satisfying their need or of assessing what the market can offer in the way of technical solutions and/or financial/legal solutions. This situation may arise in particular with the implementation of important integrated transport infrastructure projects, large computer networks or projects involving complex and structured financing the financial and legal make-up of which cannot be defined in advance."

The above Recital, in fact, gives only limited additional insight, since it mostly repeats the wording of Art.1.11's definition. Moreover, its use of the words "objectively impossible" may confuse matters by suggesting an even stricter legal test than the phrase "not objectively able" that is used in Art.1.11.

The Recital indicates that projects for integrated transport infrastructure or for large computer networks may be regarded as "particularly complex". It also refers to projects involving "structured financing", which is another vague, undefined term. Structured financing probably includes any project funding which comprises different layers or "tranches" of debt, such as multiple bank loans attracting different rates of interest and/or incurred at different levels of the private partner's corporate group or consortium. Most PPPs require financing that is to some extent "structured" in one or more of these ways.

## 7.3 Comparison with the grounds for using a competitive negotiated procedure

The ground for use of a competitive dialogue procedure, although new, overlaps considerably with the existing grounds for using the competitive negotiated procedure. For example, the definition of "particularly complex", by referring to an authority's inability to predetermine technical means, seems broadly equivalent to an inability to establish (service) contract specifications with sufficient precision, which is one ground for using a competitive negotiated procedure (as discussed in section 3.1 above). Equally, difficulties in specifying the "financial make-up" of a project, justifying use of a competitive dialogue (being another part of the definition of "particularly complex"), may be one reason why "prior overall pricing" is not possible so as to satisfy another ground for use of a competitive negotiated procedure.

Hence, there seems little doubt that some contracts, including many PPPs, will fall *both* under the grounds for a competitive dialogue (on the basis that they are "particularly complex") *and* under one or more of the grounds justifying a competitive negotiated procedure. Unfortunately, the lack of

clarity in the definitions of both sets of grounds, combined with an absence of case law, make it impossible to say precisely where the differences and dividing lines lie between the grounds for these two procedures. Given this lack of clarity, authorities awarding PPPs may well take the view that both procedures are equally available and that any risk of third party objections is equally low in both cases. Consequently, authorities are only likely to switch to using a competitive dialogue if they see some practical advantages in the procedure itself, as prescribed by the new Directive.

The process laid down in the Directive is described and discussed in section 8 below. As explained there and in section 9, the competitive dialogue procedure, in fact, appears no more flexible than the competitive negotiated procedure and may even be *more restrictive*, casting serious doubt over the usefulness of this new procedure.

## 8. The process to be followed under a competitive dialogue procedure

### 8.1 The steps laid down by Article 29

Provided the PPP contract is “particularly complex”, the awarding authority may choose to follow the competitive dialogue procedure. If so, it must follow the steps laid down in Art.29 of the new Directive, which may be summarised as follows:

1. The authority publishes a contract notice in the EU *Official Journal*, setting out its needs and requirements.
2. The authority selects a shortlist of at least three candidates in accordance with the Directive’s usual qualification rules.<sup>25</sup>
3. The authority opens a dialogue with those candidates. During this dialogue:
  - the aim “shall be to identify the means best fitted to satisfying [the authority’s] needs”;
  - the authority “may discuss all aspects of the contract” with the candidates;
  - the authority shall ensure equality of treatment among all tenderers;
  - the authority may not reveal to other participants solutions proposed or other confidential information communicated by a candidate without his or her consent;
  - the authority “may specify prices or payments to the participants”.
4. The procedure may take place “in successive stages in order to reduce the number of solutions to be discussed during the dialogue stage by applying the award criteria in the contract notice or the descriptive document”, provided that the authority stated in that notice or document that recourse may be had to this option.
5. The authority continues the dialogue “until it can identify the solution or solutions, if necessary after comparing them, which are capable of meeting its needs.”
6. The authority informs the participants that the dialogue is concluded and “asks them to submit their final tenders on the basis of the solution or solutions presented and specified during the dialogue. These tenders shall include all the elements required and necessary for performance of the contract.”
7. The authority may request that tenders be “clarified, specified and fine-tuned”, but this “may not involve changes to the basic features of the tender or the call for tender, variations in which are likely to distort competition or have a discriminatory effect.”

<sup>25</sup> Article 29(3), although the minimum of three is laid down at Art.44(3).



8. The authority selects the most economically advantageous tender, on the basis of the award criteria that it laid down.
9. The authority may ask the winning tenderer “to clarify aspects of the tender or confirm commitments contained in the tender provided this does not have the effect of modifying substantial aspects of the tender or of the call for tender and does not risk distorting competition or causing discrimination.”

It can be seen that the procedure laid down in Art.29 contains a mix of permissive and restrictive elements. On the permissive side, the Article expressly allows a dialogue between the authority and bidders, distinguishing it from the open and restricted procedures. It also states that the dialogue may relate to all aspects of the contract. Other elements, however, appear to fetter the parties' ability to negotiate freely under the procedure. A number of the key provisions are discussed further below.

## 8.2 Restriction on revealing one bidder's solution to others

Article 29(3) prohibits an authority from revealing one participant's proposed solution (or other confidential information) to the other participants without that participant's consent. It is submitted that such a restraint is appropriate. In order to encourage and reward innovation, the innovative bidder ought to be able to derive full benefit from having been the first to identify the best solution. For example, a bidder for a hospital PFI project might have the idea of constructing the required buildings on a different site, or in a completely different configuration, to that initially conceived by the authority. It would be unfair to that bidder if its clever idea were simply handed to other bidders for free.

There may be some conflict between this ban on sharing solutions and the overall purpose of the competitive dialogue, which is to identify the best means (or solution) for delivering the authority's needs *before* final tenders are invited. If, during the dialogue, the innovative idea of one participant enables the authority to identify its preferred solution but the authority does not inform the other tenderers of that preference, the final round of tenders may, in practice, serve little purpose (other than determining the price), because the tenderer offering the preferred solution is bound to win. On the other hand, there may be a price at which the preferred solution becomes too expensive, so there remains a possibility that the authority will ultimately choose a less favoured solution from a different bidder on the basis of price.

In order to guard against the risk of particular solutions being claimed as the exclusive idea of one bidder, it may be in the authority's interests to try to foresee as many possible solutions as possible and to identify these as possibilities in the invitation to tender (but without discouraging bidders from putting forward other ideas). Moreover, the authority would be well-advised to carry out a rigorous pre-qualification process at the outset, so as to minimise the risk of it being lumbered with a good solution but a contractor in whom it lacks confidence.

The old and new Directives do not lay down any equivalent express ban on sharing solutions in the context of a competitive negotiated procedure or any other procedure. Given the potential unfairness to the innovative bidder, it is arguable that the general principle of non-discrimination, applicable in all procedures, already implies a duty on an authority not to convey one bidder's bright idea to the other bidders. However, the position is far from certain and has yet to be addressed in procurement case law.

### 8.3 Ability to conduct the competitive dialogue procedure in successive stages

It is stated in Art.29(3) that the dialogue must be aimed at identifying the *means* best suited to meeting the authority's requirements. This could be read as implying that the dialogue may not serve any other purpose, such as determining which candidate(s) or tender(s) will be likely to provide the best and most economic solutions for meeting those needs. However, a more flexible interpretation appears appropriate in the light of Arts 29(4) and 44(4).

Article 29(4) expressly allows the competitive dialogue procedure to take place in successive stages with a view to reducing the number of solutions under discussion (step 4 in section 8.1 above). Article 44(4) confirms that this permits the elimination of tenderers (and not just "solutions") at each intermediate stage. Article 44(4) states that, in either a competitive dialogue or a competitive negotiated procedure, any reduction in the number of solutions or tenders shall be achieved "by applying the award criteria stated in the contract notice, in the specifications or the descriptive document." It adds that "in the final stage, the number arrived at shall make for genuine competition in so far as there are enough solutions or suitable candidates." The latter statement indicates that, by the time of the invitation of final tenders (step 6 above), the authority may have eliminated some solutions and some tenderers, giving a smaller pool of candidates than those chosen to participate at the outset of the dialogue. The rationale is explained in Recital 39, which states that:

"In a competitive dialogue and negotiated procedures. . . in view of the flexibility which may be required and the high level of costs associated with such methods of procurement, contracting authorities should be entitled to make provision for the procedure to be conducted in successive stages in order to gradually reduce, on the basis of previously indicated contract award criteria, the number of tenders which they will go on to discuss or negotiate."

The competitive dialogue and competitive negotiated procedures are therefore equally permissive in allowing the authority to carry out the award process in stages and to eliminate one or more candidates at each intermediate stage, provided this is done by reference to the authority's award criteria. Given that as few as three candidates may be invited to begin the dialogue (according to Art.44(3)), there seems to be a strong argument that the number ultimately invited to submit final tenders may be as low as two. For the reasons explained in section 4.2 above (in relation to the competitive negotiated procedure), two tenderers should usually be a sufficient number to ensure the "genuine competition" required by Art.44(4).

### 8.4 "Clarifying, specifying and fine-tuning" tenders before selection of the preferred bidder

Once the authority has identified the solution(s) that are capable of meeting its needs, it is required to inform the remaining participants that the dialogue is closed and to invite them to submit final tenders. After those steps but before selection of the preferred bidder, the second paragraph of Art.29(6) provides that "tenders may be clarified, specified and fine-tuned", subject to the condition that this step "may not involve changes to the basic features of the tender or the call for tender" to the extent that these changes are "likely to distort competition or have a discriminatory effect."

Article 29(6) therefore allows authorities some scope to ask for clarifications and adjustments to final bids, even though the "dialogue" stage has ended. The references to "clarification" and "fine-tuning" suggest that the changes must be relatively minor. The word "specifying" is more ambiguous

but may refer to confirming or adjusting the technical specifications. All of these terms have to be read subject to the requirement that the “basic features” of the tender may not be changed.

Notwithstanding those limitations, it is submitted that the pre-selection clarification or adjustments may be sufficiently great that they have a bearing on the authority’s final choice of preferred bidder. The clarification, for example, could relate to an important technical issue (for example, the quality of materials to be used) or economic element (such as the calculation method for prices or period service payments) that it would be appropriate for the authority to take into account when assessing whether the tender (as clarified) is the most economically advantageous.

The old and new Directives do not lay down any equivalent provision to Art.29(6) in relation to competitive negotiated procedures. It is nonetheless submitted that, in such a procedure, the authority has similar—if not greater—flexibility to call for clarification or adjustment of final tenders before selecting the winning tender, provided an equivalent opportunity<sup>26</sup> is given to all remaining bidders. The European Commission has recognised the need for such flexibility *after* selection of the preferred tenderer (as explained in section 5.2 above and 8.5 below) and there seems no good reason why such flexibility would not also be found earlier in the process.

### 8.5 “Clarification” and “confirmation” after selection of the preferred tender

After the authority has chosen the most economically advantageous tender, the second paragraph of Art.29(7), allows the authority to ask the preferred tenderer “to clarify aspects of the tender or confirm commitments contained in the tender.” The provision is subject to the condition that this step “does not have the effect of modifying substantial aspects of the tender or of the call for tender and does not risk distorting competition or causing discrimination.”

It is not clear precisely what is permitted by this provision. It refers only to clarification and confirmation, suggesting that it may be intended to be more restrictive than Art.29(6), which also permitted (pre-selection) the “specification” and “fine-tuning” of tenders. Article 29(7) does not expressly allow for post-selection *changes* to tenders. On the other hand, the prohibition on “modifying substantial aspects” could be interpreted as implying that changes to *non-substantial* aspects are permitted. It is also unclear whether these “substantial aspects” are more significant, or less so, than the “basic features” which may not be changed pre-selection under Art.29(6).

The final sentence of the new Directive’s 29th Recital may be of some relevance on this point. It states that “this [competitive dialogue] procedure may not be used in such a way as to restrict or distort competition, particularly by altering any fundamental aspects of the offers, or by imposing substantial new requirements on the successful tenderer, or by involving any tenderer other than the one selected as the most economically advantageous.” The references to “fundamental aspects” and “substantial new requirements” again suggest that some lesser, but still significant, changes are permitted and that such changes may go beyond the mere “clarification” and “confirmation” referred to in Art.29(7).

In conclusion, the above rules of the competitive dialogue procedure are unclear regarding the extent to which there may be post- (and pre-) tender negotiations with the preferred tenderer and changes to its tender. In section 5 above, it was explained that the Directives are silent on this issue in relation to competitive negotiated procedures but that, in its recent decisions, the European

<sup>26</sup> Equivalent does not necessarily mean identical. Clarification may be needed to varying degrees and on different points, in relation to the different tenders.

Commission has allowed considerable flexibility for post-tender negotiations and changes in the context of large infrastructure projects.

The new Directive therefore leaves considerable uncertainty as to whether the scope for post-tender negotiations and changes in a competitive dialogue procedure is smaller, greater or the same as that allowed under a competitive negotiated procedure. If anything, the express rules of the competitive dialogue procedure on this point (discussed above) appear *more restrictive* than the general principles that have been applied to competitive negotiated procedures. Given that post-tender negotiations are an essential and unavoidable step towards concluding any major project agreement, it is submitted that this (potential) inconsistency between the two procedures will be one further factor that is likely to induce authorities to continue using the competitive negotiated procedure rather than switching to the new competitive dialogue.

## 9. Conclusion

The competitive negotiated procedure under the new Directive has the laudable aim of attempting to introduce a more flexible process that is suitable for the award of large and complicated projects. Unfortunately, that aim is likely to be undermined by a number of factors.

First, the competitive dialogue is made available only in relation to “particularly complex” contracts. The definition of such contracts is vague and appears to overlap with the grounds for using the existing competitive negotiated procedure. When awarding large infrastructure contracts, contracting authorities and, ultimately, the courts should be encouraged to take a wide view of what constitutes a sufficiently complex contract for this purpose. Nonetheless, awarding authorities may consider that the same lingering legal doubt attaches to the availability of the competitive dialogue as that which already surrounds recourse to a competitive negotiated procedure.

Secondly, the new Directive lays down in some detail the steps to be undertaken in a competitive dialogue procedure. While some of these provisions, such as the right to narrow down the solutions in successive stages, do help to ensure flexibility, some other elements are more restrictive. For example:

- the aim of the dialogue is confined to identifying the means best suited to satisfying the authority’s needs;
- the authority is prohibited from revealing one bidder’s solution to the other bidders; and
- there appears to be only limited right to clarify or adjust final tenders either before or after selection of the preferred bidder.

These detailed procedural provisions contrast with the much looser regulation of competitive negotiated procedures, where the process is largely left to the discretion of the authority. For example, no attempt is made to prescribe the level of post-tender negotiations that may be undertaken in a competitive negotiated procedure. Hence, even though courts may ultimately apply similar standards and controls to both procedures, there remains at least a perception that the competitive negotiated procedure is more flexible than the competitive dialogue.

In conclusion, given the above uncertainties surrounding both the availability and the flexibility of a competitive dialogue procedure, it is likely that when awarding large infrastructure projects, many authorities will indeed decide “better the devil you know” and continue to opt for the competitive negotiated procedure. Consequently, it is doubtful whether the new competitive dialogue procedure will be a success.

More fundamentally, the introduction of the competitive dialogue procedure contradicts the new Directive's stated aims of clarification and simplification. It means that there now exists two parallel procedures, which appear to be aimed at similar situations and to involve similar and yet distinct processes, and between which the dividing lines are blurred. This change therefore adds another layer of complexity and uncertainty to the procurement rules. It is submitted that a clearer and simpler solution would have been to expand and clarify the existing competitive negotiated procedure. The grounds for its availability could have been widened and simplified, and its procedural requirements clarified. Awarding authorities would not then have been faced with an entirely new "devil", in the form of the competitive dialogue, which they are bound to approach with some caution.

# Competitive Dialogue

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## 1. Introduction

The competitive dialogue is surely most welcomed by practitioners in the field of public procurement for its contribution to make the EC public procurement regime more flexible and the elaboration of this new procedure has been given much attention during the negotiation process. The original proposal for a new Directive, COM (2000) 275, introduced specific rules on particularly complex contracts which was severely criticised both in legal theory<sup>2</sup> and by the parties involved in the decision-making process. This led to a number of fundamental changes<sup>3</sup> and the final result<sup>4</sup> is now a procedure, which at least on a number of points lives up to the much-desired requirements for flexibility. However, the drafting of the relevant provisions and namely the main provision on competitive dialogue in Art.29 has some shortcomings and does not necessarily lead to clarity and simplicity.<sup>5</sup> The purpose of this article is to outline the fundamental aspects of the procedure and to analyse its implications.

## 2. Ground for use of competitive dialogue

It follows from Art.29(1) that in the case of particularly complex contracts, Member States may provide that, where contracting authorities consider that the use of the open or restricted procedure will not allow the award of the contract, the latter may make use of the competitive dialogue in accordance with Art.29. If the Member State in question has provided the legal basis for the competitive dialogue procedure, the first condition is that the contract shall be awarded on the sole basis of the award criterion for the most economically advantageous tender<sup>6</sup> and the second condition is that the contract is particularly complex.

One might expect that the long Art.29 on competitive dialogue would contain guidance

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<sup>2</sup> cf. the highly relevant criticism submitted by Boyle, "Critique of the Commission's Proposal for a New Directive on the Co-ordination of Procedures for Public Contracts COM (2000) 275 Final, as updated by the discussions in the Working Group" (2001) 10 P.P.L.R. NA65 and Arrowsmith, "The European Commission's Proposals for New Directives on Public and Utilities Procurement" (2000) 9 P.P.L.R. NA126.

<sup>3</sup> The adopted version corresponds to a very high degree to the second proposal from the Commission, COM (2002) 236.

<sup>4</sup> This Article is based on the Directive of the European Parliament and of the Council on the co-ordination of procedures for the award of public works contracts, public supply contracts and public service contracts. Joint text approved by the Conciliation Committee (draft). 2000/0155 (COD) C5-0607/2003.

<sup>5</sup> However, the drafting has clearly improved when the adopted Directive is compared with the original proposal, COM (2000) 275. Article 30 in the latter was characterised as an example of "the very worst kind of drafting" by Arrowsmith, "The European Commission's Proposals for New Directives on Public and Utilities Procurement" (2000) 9 P.P.L.R. NA126 (130).

<sup>6</sup> The same condition applies to a contracting authority's acceptance of alternative offers which, like the competitive dialogue procedure, is an exemption from the so-called ban on negotiations.

concerning the meaning of “particularly complex” contracts but the reader of the Directive will look in vain in this Article. Instead, guidance is to be found in Art.1(11)(c) where it is stated that for the purpose of recourse to the procedure mentioned in the first sub-paragraph, a public contract is considered to be “particularly complex” where the contracting authorities are not objectively able to define the technical means in accordance with Art.23(3)(b), (c) or (d), capable of satisfying their needs or objectives, and/or are not objectively able to specify the legal and/or financial make-up of a project. There is not a positive list in this provision or any mentioning of concrete examples of areas likely to fall within the scope of the concept “particularly complex”. However, Recital 31 of the Directive gives further guidance and mentions a few areas. It follows from this Recital that:

“Contracting authorities which carry out particularly complex projects may, without this being due to any fault on their part, find it objectively impossible to define the means of satisfying their needs or of assessing what the market can offer in the way of technical solutions and/or financial/legal solutions. This situation may arise in particular with the implementation of important integrated transport infrastructure projects, large computer networks or projects involving complex and structured financing the financial and legal make-up of which cannot be defined in advance.”

The wording of the main provision on competitive dialogue in Art.29 gives the impression that the contracting authorities are allowed a relative wide discretion on when a contract is particularly complex, *cf.* the words “where contracting authorities consider that the use of the open or restricted procedure will not allow the award of the contract”. However, that this is definitely *not* the case becomes apparent when Art.11(3)(c) supplements Art.29 as it is stressed that the contracting authorities “objectively” are not able to define the technical means or to specify the legal or financial make-up of a project. From Recital 31, follows that the impossibility must not be due to any fault on the part of the contracting authority. This line in the recital and the meaning of “objectively” becomes much clearer when it is read in conjunction with the remarks from the Commission in the original proposal for the new Directive in COM (2000) 275. Here, it is expressed that:

“the complexity must be established and able to be objectively justified by the contracting authority. This does not therefore concern subjective impossibility, *i.e.* due to deficiencies on the part of the contracting authority itself. The authority may not simply affirm that it is unable to provide a definition or an evaluation. On the contrary, the contracting authority must prove that this is objectively impossible, given the nature of the specific contract. Depending on the case, this might mean that the contracting authority would be required to prove that there are no precedents for the project, or that disproportionate time or money would be required to acquire the necessary knowledge.”

It follows from the above-mentioned, that the use of the competitive dialogue is restricted to particularly complex contracts, which is a concept that is narrowly defined, and that the burden of proving that the contract in question is particularly complex is on the shoulders of the contracting authority. However, contracting authorities are likely to interpret the concept of particularly complex contracts in a wide sense in order to escape the open and restricted procedures and surely the competitive dialogue will be applied in many cases where it is not justified. It is going to be interesting to see which line of interpretation and enforcement the relevant bodies at national and European level will follow. There is a chance that they will interpret the grounds for using the competitive dialogue less restrictive than the wording of the new Directive prescribes in order to allow a higher degree of

flexibility. If they do not, this part of the revision of the public procurement rules has been much ado about nothing, as only a very limited number of procedures will fulfil the strict requirements for the use of the competitive dialogue.

### 3. The procedure

According to the definition in Art.1(11)(c)—

“competitive dialogue is a procedure in which any economic operator may request to participate and whereby the contracting authority conducts a dialogue with the candidates admitted to that procedure, with the aim of developing one or more suitable alternatives capable of meeting its requirements, and on the basis of which the candidates chosen are invited to tender.”

The procedure operates with a fundamental distinction between dialogue before and after invitations to submit a bid. In the stage before the invitation to submit a bid, dialogue on all aspects of the contract is permitted, (Art.29(3)) whereas the traditional ban on negotiations with some modifications limit the dialogue after the invitation to submit a bid. As will be outlined below, the limitations on dialogue after the invitations to submit are likely to be more of a formality than a reality.

The procedure starts with the publication of a contract notice setting out the needs and requirements of the contracting authority, which they shall define in that notice and/or in a descriptive document. It is to be expected that the tender notice and descriptive document will contain less information than usual tender documentation, as the purpose of the technical dialogue is to identify a solution to a complex need. Annex VII to the Directive outlines several requirements to the information in the tender condition or descriptive document and some of these requirements will be mentioned below.

#### 3.1 Shortlisting of candidates and solutions

Candidates for participation in the competitive dialogue are selected in accordance with the relevant provisions in Arts 44 to 52, (Art.29(3)). If the contracting authority applies the option for reducing the number of candidates to be engaged in the technical dialogue, it has a duty to indicate the minimum and, if appropriate, proposed maximum number of candidates and objective criteria to be used to choose that number of candidates, *cf.* Annex VII(20).

The contracting authority does not only have the possibility to shortlist the number of candidates based on financial and technical qualifications as mentioned above but has also the possibility to shortlist the solutions and thereby indirectly the number of participants<sup>7</sup> during the dialogue.<sup>8</sup> This option follows from Art.29(3) according to which a contracting authority may provide for the procedure to take place in successive stages in order to reduce the number of solutions to be discussed during the dialogue stage. This presupposes that the contract notice or the descriptive document indicate that recourse may be had to this option (Art.29(3) and Annex VII(19)). It further follows from

<sup>7</sup> It is worth noting that it is the solutions that are shortlisted and not necessarily the participants. A participant can have suggested several solutions and is only out of competition if all his solutions are shortlisted.

<sup>8</sup> The original proposal was criticised for the lack of this possibility, *cf.* Boyle, “Critique of the Commission’s Proposal for a New Directive on the Co-ordination of Procedures for Public Contracts COM (2000) 275 Final, as updated by the discussions in the Working Group” (2001) 10 P.P.L.R. NA65 (68).



Annex VII(20) that the contracting authority shall indicate the minimum and, if appropriate, proposed maximum number of candidates and objective criteria to be used to choose that number of candidates. The shortlisting of solutions shall be done by applying the award criteria in the contract notice or in the descriptive document (Art.29(3)). There is no possibility to change the award criteria during the dialogue stage although this was an option foreseen in the original proposal, COM (2000) 275.<sup>9</sup> As mentioned previously, the parties may discuss all aspects of the contract which also must include price and the participants interim pricing is likely to be of great importance for their continued participation in the procedures with a phased dialogue. It is to be expected that contracting authorities will frequently apply the possibility to shortlist during the dialogue phase. This will be a consequence of the fact that it will be an extremely expensive business for both contracting authorities and bidders to participate in a competitive dialogue and many candidates will be reluctant to invest greatly in the participation unless they are in a small group of bidders.<sup>10</sup>

### 3.2 The ban on “cherry picking”

It follows from Art.29(3) that the contracting authorities may not reveal to the other participants solutions proposed or other confidential information communicated by a candidate participating in the dialogue without his/her agreement. This provision has to be read in conjunction with Art.29(6) according to which, the contracting authority shall ask the participants in the procedure to submit their final tenders on the basis of the solution or solutions presented and specified during the dialogue. From this, it follows that the so-called “cherry picking” is not allowed unless the participant agrees and that each participant must submit a bid based on its own proposal for a solution.

The Commission’s first proposal met strong objections from trade and industries because it allowed “cherry picking” as the proposal made it possible for the contracting authority to define the final technical specifications either by retaining one of the solutions presented by one of the participants or by combining the solutions presented to it.<sup>11</sup> The adopted rule was inserted in order to strike a better balance between the interests of the contracting authority and the participants in the procedure.

Many contracting authorities are likely to question the practicality of this crucial limitation in the dialogue and one could argue that the chances of developing any serious discussion on this basis will be low.<sup>12</sup> It is sometimes difficult to predict the future but in this case it is easy: a considerable number of contracting authorities will be tempted to set aside the ban on cherry picking in order to obtain value for money.<sup>13</sup> If the contracting authorities, in general, have difficulties respecting the ban on cherry picking there is a risk that the competitive dialogue procedure as such will be a failure, as many potential tenderers will choose not to participate in tender procedures with competitive dialogue.

<sup>9</sup> This option was removed with the second proposal, COM (2002) 236, where the Commission explained that the possibility for changing the award criteria during the procedure would imply a serious risk of manipulation as the idea of bidding on a common solution had been given up due to fear for cherry picking.

<sup>10</sup> *cf.* Boyle, “Critique of the Commission’s Proposal for a New Directive on the Co-ordination of Procedures for Public Contracts COM (2000) 275 Final, as updated by the discussions in the Working Group” (2001) 10 P.P.L.R. NA65 (66).

<sup>11</sup> It was stated in Art.30(6) of the original proposal, COM (2000) 275, that *during negotiation*, the contracting authorities may not disclose to the other participants the solutions proposed or any other confidential information given by a participant. The wording of Art.29(3) in the adopted version of the Directive does not have a similar limitation in time.

<sup>12</sup> *cf.* Boyle, “Critique of the Commission’s Proposal for a New Directive on the Co-ordination of Procedures for Public Contracts COM (2000) 275 Final, as updated by the discussions in the Working Group” (2001) 10 P.P.L.R. NA65 (67).

<sup>13</sup> The majority of violations in Danish public procurement practice appears to be driven by the desire to obtain value for money, *cf.* Treumer, *Ligebehandlingsprincippet i EU’s udbudsregler* [The Principle of Equal Treatment of tenderers in the EC Public Procurement Rules], 2000 (Ph.D.thesis) 285.

There have been several cases in Danish public procurement practice where tenderers have refrained from submitting a bid once it has become apparent that the contracting authority did not observe the law for one reason or another. Trust in the contracting authority's fairness and respect for the law becomes more important when a tenderer considers participating in competitive dialogue, as it is very costly to participate in the dialogue.

As mentioned above, there is an important exception to the ban on cherry picking as the participants in the procedure can agree that their solutions or other confidential information can be revealed and applied by the contracting authority (Art.29(3)). It is to be expected that the contracting authorities will be eager to get the agreement of the participants in the procedure. The contracting authorities can specify prices and payments to the participants in the dialogue (Art.29(8)),<sup>14</sup> which is likely to make it easier to get the agreement of the firms involved. The price needs, not only to reflect the time invested in the participation but also the fact that the firm accepts to share its know how with consequences for both the competition for the contract in question and the future. The participant with a preferred solution will normally have a competitive advantage that might ease the efforts of the contracting authorities to get the agreement of the participant in question. If a participant does not agree to share its solutions, there is the risk that the firm is not invited to submit a bid and that the contracting authority will apply the solution anyway in a more or less modified version in the individual invitations to the other participants. It will be difficult for the participant in question to know if such a violation has taken place as the participant does not have access to the solutions of the other parties presented in the course of the competitive dialogue and normally cannot get access to the final contract with the winner of the competition.

It is not quite clear if a contracting authority can insert a *tender condition* in the contract notice or descriptive document to the effect that the participants must accept that the contracting authority may share its solution with the other participants in the competitive dialogue. It is submitted that a contracting authority can insert such a condition in the tender conditions as the participants are made aware of the foreseen procedure when they enter the competition and before they have submitted their solution. However, a contracting authority using such a tender condition, from the very outset of the procedure, risks that the procedure becomes a failure as the potential tenderers in general might oppose the idea of sharing their solutions and know how.

### 3.3 The invitation to submit a final tender

The dialogues continue until the contracting authority can identify the solution or solutions which are capable of meeting its needs, (Art.29(5)) and the dialogue is then declared concluded by the contracting authority who shall inform the participants of the conclusion (Art.29(6)). The contracting authority shall then ask the participants to submit their final tenders on the basis of the solution or solutions presented and specified during the dialogue (Art.29(6)).

It is worth noticing that the contracting authority can limit itself to one solution. It might be that a number of participants have suggested a more or less identical solution or that the contracting authority has obtained the agreement of the participants to "cherry picking" but it might also be that there only remains one solution from one of the participants. If the latter is the case, it follows from the

<sup>14</sup> The express provision on the access to specify payment was inserted in the first proposal, COM (2000) 275. As pointed out by Arrowsmith, "The European Commission's Proposals for New Directives on Public and Utilities Procurement" (2000) 9 P.P.L.R. NA126 (130), this rule probably, or arguably, applies in any case, under the negotiated procedures.

Directive that the contracting authority may settle with inviting the remaining participant.<sup>15</sup> This underlines the crucial importance that the shortlisting of solutions might have for the outcome of a competitive dialogue.

A tenderer appears to be able to submit more than one bid if the contracting authority has considered that more than one of his solutions are capable of meeting its needs. However, it is to be expected that this will normally not be the case as it will be very costly for the tenderer in question to submit two tenders and the dialogue on all aspects of the contract is likely to have narrowed down the number of solutions of particular interest to one single solution.

It is worth stressing that there are no explicit requirements to the invitation to submit the final tender and the contracting authority will normally not be able to inform the other participants of the draft or final solutions of their competitors unless the participants have agreed to share their solution or information with the other participants (Art.29(3)).<sup>16</sup> The contracting authority is left with a very wide discretion concerning the invitation to submit a final bid. It can limit itself to sending out an invitation letter briefly outlining the most important requirements and agreed elements in the solution or it can instead opt for an invitation accompanied by very detailed specifications. The lack of regulation on this point has important implications for the possibilities to negotiate after the submission of the final bid, which will be considered below in the analysis of the procedure after submission of bids.

### 3.4 After submission of bids

As mentioned earlier, the procedure operates with a fundamental distinction between dialogue before and after invitations to submit a bid. In the stage before the invitation to submit a bid, dialogue on all aspects of the contract is permitted, (Art.29(3)) whereas the traditional ban on negotiations with some modifications<sup>17</sup> limits the dialogue after the invitation to submit a bid. The possibilities for dialogue with the tenderers is regulated in Art.29(6) and (7). It follows from Art.29(6) that the tenders may be clarified, specified and fine-tuned at the request of the contracting authority and that this dialogue may not involve changes to the basic features of the tender or the call for the tender which would be likely to distort competition or to have a discriminatory effect. It further follows that the tenderer identified as having submitted the most economically advantageous tender may be asked to clarify aspects of the tender or to confirm commitments contained in the tender provided this does not have the effect of modifying substantial aspects of the tender or the call for tender and does not risk distorting competition or causing discrimination (Art.29(7)).<sup>18</sup>

It is not quite clear if it is only the contracting authority who can take the initiative to have the tenders clarified, specified or fine-tuned but this appears to be the case if one applies a strict interpretation of the wording of the Directive where it is spelled out that such dialogue takes place “at

<sup>15</sup> The adopted Directive deviates on this point from the original proposal, COM (2000) 275, according to which the contracting authority had to invite a minimum of three tenderers, *cf.* Art.30(7) in this proposal.

<sup>16</sup> The adopted version of the Directive differs considerably in this respect from the original proposal, COM (2000) 275, *cf.* Art.30(7) and Art.30(1) in this proposal.

<sup>17</sup> The European Parliament and several Member States, including the United Kingdom, Germany and Austria advocated for widened access to negotiations after the submissions of bids in response to the first proposal, COM (2000) 275 for a new Directive.

<sup>18</sup> This idea of an explicit legal basis for negotiations with the winning bidder appear to have been introduced by the European Parliament and was modified with the Commission's second proposal, COM (2002) 236.

the request of the contracting authority". Such an interpretation would deviate from the common interpretation of the ban on negotiation according to which, both the contracting authority and the tenderers can take the initiative to clarification of the tender and tender documents. It is submitted that the Directive shall be interpreted in compliance with the latter interpretation and that the participants in the competitive dialogue can also take the initiative to clarification, specification and fine-tuning. That a tender can be "fine-tuned" is a new feature, which was inserted on the initiative of the European Parliament, and with the introduction of this concept it is explicitly accepted that the tenders can be changed on various points provided this does not involve basic features of the tender. Surely the concept of fine-tuning will be given a wide interpretation by contracting authorities and tenderers in practice to come.

When the above-mentioned modifications in Art.29(6) and (7) are considered, the modifications to the ban on negotiations appears to be of minor importance. However, the ban on negotiations risks becoming much more of a formality than a reality due to another part of the procedure. As mentioned earlier, there are no explicit requirements to be observed when the contracting authority sends out its invitation to tender after the conclusion of the dialogue stage and the contracting authority will normally not be able to inform the competitors of the specifications outlined in the invitations to each participant. The contracting authority is left with a very wide discretion concerning the invitation to submit a final bid. It can limit itself to sending out an invitation letter briefly outlining the most important requirements and agreed elements in the solution or it can instead opt for an invitation accompanied by very detailed specifications. The lack of regulation on this point has important consequences for the possibilities to negotiate after the submission of the final bid. The contracting authority will of course be able to use the lack of transparency on draft and final solutions to enter into widespread negotiations with the tenderers. The latter has practically no chance of knowing when this is actually the case or of proving that widespread negotiations have taken place if the case is brought before a review body. The wide margin of discretion can also be of importance to a tenderer if he is rejected for having submitted a final tender not complying with the agreed solution. Such a tenderer might also find it difficult to prove that the tender was in compliance with the agreed solution if the contracting authority has opted for a brief outline of the solution in the invitation in the tender even.<sup>19</sup> To conclude, the possibilities for conducting illegal negotiations after the submissions appears to be excellent and can normally be performed at a low risk.

### 3.5 Cases justifying use of the negotiated procedure

It is not always the case that the competitive procedure can be completed with the award of the contract and the contracting authority is explicitly allowed to use the negotiated procedure with prior publication of a contract notice in the event of irregular tenders or the submission of tenders which are unacceptable under national provisions compatible with Arts 4, 24, 25, 27 and Ch.VII, in response to a competitive dialogue in so far as the original terms of the contract are not substantially altered (Art.30(1)(a)). It is further stated in this provision that the contracting authority need not publish a contract notice where they include, in the negotiated procedure all of, and only, the tenderers which satisfy the criteria of Arts 45 to 52 and which, during the prior competitive dialogue, have submitted tenders in accordance with the formal requirements of the tendering procedure.

<sup>19</sup> However, the tenderer can, in some cases, be able to prove the main requirements concerning his solution by submitting documents from the various stages in the dialogue, which to some extent will protect the tenderer from being unjustifiably rejected for having submitted an irregular tender.

The likelihood of the irregularity of the tenders appears to be low when it is taken into consideration that the contracting authority and the tenderers have been engaged in a detailed dialogue on all aspects of the contract, (Art.29(3)) and that the tenders can be clarified, specified and fine-tuned (Art.30(6)). It appears more likely that the contracting authority is faced with a situation where no tenders<sup>20</sup> or no suitable tenders or no applications for participation<sup>21</sup> have been submitted in response to a competitive dialogue. In such a situation, it could be expected that there was explicit legal basis for the use of the negotiated procedure without publication of a contract notice which is the case for similar situations when the open or restricted procedure has been applied (Art.31(1)(a)). However, this is not the case and a reasonable explanation for this appears to be lacking. It is submitted that an analogy from Art.31(1)(a) would be relevant if a contracting authority is faced with this situation.

#### 4. Conclusions

The use of the competitive dialogue is restricted to particularly complex contracts, which is a concept that is narrowly defined, and the burden of proving that the contract in question is particularly complex clearly lies on the shoulders of the contracting authority. However, contracting authorities are likely to interpret the concept of particularly complex contracts in a wide sense in order to escape the ban on negotiations relevant to the open and restricted procedures. It is beyond reasonable doubt that the competitive dialogue will be applied in many cases where it is not justified. Only time can tell which line of interpretation and enforcement the relevant bodies at national and European level will follow. There is a chance that they will interpret the grounds for using the competitive dialogue less restrictively than the wording of the new Directive prescribes. If they do not, this part of the revision has been much ado about nothing, as only a very limited number of procedures will fulfil the strict requirements for the use of the competitive dialogue.

The procedure operates with a fundamental distinction between dialogue before and after invitations to submit a bid. In the stage before the invitation to submit a bid, dialogue on all aspects of the contract is permitted, (Art.29(3)) whereas the traditional ban on negotiations with some modifications of minor importance in Art.29(6) and (7) limit the dialogue after the invitation to submit a bid. However, the lack of transparency concerning the final specifications and the dialogue that has taken place with each individual participant will in practice “allow” the contracting authority to enter into widespread negotiations with the tenderers. The latter has practically no chance of knowing when this is actually the case or of proving that widespread negotiations have taken place if the case is brought before a review body. To conclude, the possibilities for conducting illegal negotiations after the submissions appears to be excellent and can normally be performed at a low risk.

It follows from Art.29(3) that the contracting authorities may not reveal to the other participants solutions proposed or other confidential information communicated by a candidate participating in the dialogue without his agreement. This provision has to be read in conjunction with Art.29(6)

<sup>20</sup> This situation could very well happen where there are only one or two remaining participants in the final stage of the competitive dialogue and the participants are consortia, which are split up due internal disagreement between the members of the consortia or bankruptcy.

<sup>21</sup> This situation could easily occur if a contracting authority inserts a clause in the tender conditions permitting the sharing of the solutions of the participants (cherry picking) in a situation where the potential participants strongly opposes such an approach.

according to which the contracting authority shall ask the participants in the procedure to submit their final tenders on the basis of the solution or solutions presented and specified during the dialogue. From this, it follows that the so-called “*cherry picking*” is not allowed unless the participant agrees and that the contracting authority cannot invite the participants on the basis of one of the solutions presented by one of the participants or by combining the various solutions presented to it. Instead the main rule is that each participant must submit a bid based on its own proposal for a solution. Many contracting authorities are likely to question the practicality of this crucial limitation in the dialogue. It is sometimes difficult to predict the future but in this case it is easy: a considerable number of contracting authorities will be tempted to set aside the ban on cherry picking in order to obtain value for money. If the contracting authorities, in general, have difficulties respecting the ban on cherry picking there is a risk that the competitive dialogue procedure as such will be a failure as it is unlikely that many potential tenderers will invest considerable time and money and participate in competitive dialogue under such conditions.

It has been suggested in this analysis of the competitive dialogue that the drafting of the provisions on competitive dialogue, including the main provision on the subject in Art.29, has some shortcomings and does not live up to the desired level concerning of clarity and simplicity. Taking into consideration the many and conflicting interests this is, however, understandable. The final result appears, in general, to strike an appropriate balance between relevant considerations and interests and the competitive dialogue will surely be most welcomed by practitioners in the field of public procurement for its contribution to make the EC public procurement regime more flexible.

# Secondary Policies in Public Procurement: The Innovations of the New Directives

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## 1. Introduction

Public contracts represent a significant part of the European economy, include very large projects, and are crucial to economic and technological development. Because of these characteristics, but also because of the peculiar place of contracting authorities and entities in society, public purchases are very visible and politically sensitive. For all these reasons, public procurement is a very seductive political tool and has traditionally been used as such.

Public procurement may be used to favour surreptitiously national or local industry, political friends or companies that finance the party in power. Public procurement may also be used openly and officially as a tool to promote objectives which are unconnected with the subject-matter of the contract: these objectives can be referred to as “secondary” policies, the primary objective of procurement being the acquisition of goods, services or works on the best possible terms.<sup>1</sup> Secondary policies may be, for instance, the protection of the environment (in Luxembourg, public authorities favour PVC-free products), the development of less-favoured regions (in Italy, the preference for the bids from companies in the Southern regions),<sup>2</sup> the struggle against unemployment (in France, public authorities favouring companies recruiting unemployed workers),<sup>3</sup> the support to workers participation in the management of the company (preference for co-operatives in France),<sup>4</sup> the struggle against sectarian movements (in Germany, the policy against entities linked with the church of Scientology)<sup>5</sup> or the isolation of foreign States on the internal scene (in the United Kingdom, one of the reasons for enacting s.17 of the Local Government Act 1988 was to prevent local authorities from excluding companies trading with South Africa).<sup>6</sup>

The very reason for the existence of national and EC rules on the award of public procurement is to avoid discrimination and exclude hidden favouritism. The question whether, on the other hand, the use of public contracts to openly promote secondary policies, and in particular environmental and

<sup>1</sup> Sue Arrowsmith, “Public Procurement as an instrument of policy and the impact of market liberalisation” (1995) 111 L.Q.R. 235.

<sup>2</sup> See Case C-360/89 *Commission v Italy* [1992] E.C.R. I-3401. S. Arrowsmith, “The Legality of ‘Secondary’ Procurement Policies under the Treaty of Rome and the Works Directive” (1992) 1 P.P.L.R. 410.

<sup>3</sup> See Case C-225/98 *Commission v France* [2000] E.C.R. I-7445. J. Arnould, “A Turning Point in the Use of Additional Award Criteria?” (2001) 10 P.P.L.R. NA13.

<sup>4</sup> Article 54 of the new French Public Procurement Code of January 2004.

<sup>5</sup> Hans-Joachim Pieß and Christian Pitschas, “The Use of Secondary Policy Criteria in Public Procurement Procedures: the Burma Case and the German Scientology Declaration” (2000) 9 P.P.L.R. NA111.

<sup>6</sup> Sue Arrowsmith, “Public Procurement as an instrument of policy and the impact of market liberalisation”, n.1 above.

social objectives, may be considered as legitimate and legal, has been at the heart of the debates relating to the application of the EC public procurement Directives during the recent years and was one of the most disputed issues of the preparatory works of the new Directives. The public procurement Directives are based on internal market provisions of the EC Treaty. However, pursuant to Art.6 of this Treaty, environmental protection requirements are to be integrated in the definition and implementation of Community policies, and social progress and the strengthening of social cohesion are also amongst the objectives of the Community.

It is doubtful that the adoption of the new Directives has brought this debate to an end.

## 2. Secondary policies under the old Directives

The old (current) public procurement Directives<sup>7</sup> did not ignore secondary policies. Quite significantly, for instance, the Works Directive provided for a phasing out of preference schemes existing in the Member States. Pursuant to this Directive, national legislation providing for a preference, the aim of which was the reduction of development differences between regions, was allowed, if it was not contrary to the EC Treaty, but only until December 31, 1992. Moreover, the same Directive provided that Member States were allowed to apply preferences derogating from the rule that the contract must be awarded to the lowest or the economically most advantageous bid, only in so far as such schemes were already in force when the Works Directive was adopted. The Supply and the Service Directives and the Utilities Directive did not contain similar provisions: the transitional provisions existing with regard to works contracts were not considered to be necessary for other contracts, in particular because no existing national scheme would have been eligible.<sup>8</sup>

In this context, in the *Beentjes* case, which was the first case concerning secondary procurement policies brought before the European Court of Justice, the Court, contrary to the opinion of its Advocate General, took a rather flexible position, and admitted, to a certain extent, the possibility to take into account objectives of general interest in public procurement.<sup>9</sup> The European Commission then published a first communication on this issue, in which it gave its interpretation of the Court's "case law".<sup>10</sup> According to this interpretation, the possibility for contracting authorities to promote secondary policies was restricted. In this communication, the Commission also announced that it would bring before the Court the Member States that maintained preference schemes which were contrary to the Treaty and the Directives. The Commission's action against Italy was upheld by the Court.<sup>11</sup>

<sup>7</sup> Directive 92/50/EEC of June 18, 1992 relating to the co-ordination of procedures on the award of public service contracts [1992] O.J. L209/1; Directive 93/36/EEC of June 14, 1993 co-ordinating procedures for the award of public supply contracts [1993] O.J. L199/1; Council Directive 93/37 of June 14, 1993 concerning the co-ordination of procedures for the award of public works contracts [1993] O.J. L199/54 and Directive 93/38/EEC of June 14, 1993 co-ordinating the procurement procedures of entities operating in the water, energy, transport and telecommunications sectors [1993] O.J. L199/84. These four Directives were last amended by Commission Directive 2001/78/EC of September 13, 2001, [2001] O.J. L285/1.

<sup>8</sup> See, for instance, with regard to supply contracts, COM (92) 346 final, September 7, 1992 and with regard to service contracts, COM (91) 233 final, August 30, 1991.

<sup>9</sup> Case 31/87 *Beentjes v Netherlands State* [1988] E.C.R. 4635.

<sup>10</sup> Public Procurement. Regional and social aspects, COM (89) 400 final, September 22, 1989, [1989] O.J. C311/17.

<sup>11</sup> Case C-360/89 *Commission v Italy*, n.2 above.



The Commission's interpretation of the Directives was confirmed in the Green Paper of 1996<sup>12</sup> and in the Communication of 1998.<sup>13</sup> The two judgments of the Court and the Commission's communications were the only available source of guidance on the issue of secondary procurement policies until the presentation of the Commission's proposals for new Directives.

### 3. The Commission's proposals for a preservation of the status quo

In the two proposals submitted on May 10, 2000,<sup>14</sup> the Commission did not propose to make any change to the applicable law on this point. The Commission also considered it unnecessary to codify the interpretation of the existing rules in the new Directives: a series of communications would better deal with this issue.

However, refining and developing the Commission's doctrine on the way, to take into account social and environmental considerations in public procurement, apparently proved to be difficult and was an excessively long procedure. Whereas the Commission indicated in 1996 that it was envisaging the publication of communications giving more detailed guidelines on this issue, and in 1998, the Commission formally undertook to adopt these communications before mid-1999, its works had still produced no result at the time the proposals for new Directives were presented. It seems that the Commission, rather than taking a proactive position and publishing communications based on its interpretation of the existing rules, waited for a confirmation of the Court's case law. In the hope for such a confirmation, the Commission defended its interpretation by bringing France before the European Court of Justice in a case concerning works contracts concluded in 1993 for the construction of secondary schools in the North of France. Quite unexpectedly, the Court refused to endorse the interpretation of the Directives that the Commission had developed on the basis of its understanding of the *Beentjes* case.<sup>15</sup>

This judgment imposed on the Commission the necessity of amending its position on this issue and finding a new global interpretation of the texts within which both the *Beentjes* and the *Commission v France* cases would fit. The Commission then published two communications concerning, respectively, social and environmental objectives and public procurement.<sup>16</sup> At the same time, the Commission's failure to obtain a confirmation of the position it had defended before the Court led to debate amongst the members of the other institutions and organs of the Community to which the two proposals for new Directives had been submitted. The Commission's choice of not to mention secondary policies in its proposals had been criticised by the Committee of the Regions and the Social

<sup>12</sup> Green Paper on Public Procurement in the European Union: Exploring the way forward, COM (96) 543, 27 November 1996.

<sup>13</sup> Public Procurement in the European Union, COM (98) 143 final, March 11, 1998.

<sup>14</sup> Proposal for a Directive of the European Parliament and of the Council on the co-ordination of procedures for the award of public supply contracts, public service contracts and public works contracts, COM (2000) 275 final, May 10, 2000 and Proposal for a Directive of the European Parliament and of the Council co-ordinating the procurement procedures of entities operating in the water, energy and transport sectors, COM (2000) 276 final, May 10, 2000.

<sup>15</sup> Case C-225/98 *Commission v France*, n.3 above.

<sup>16</sup> Interpretative communication on the Community law applicable to public procurement and the possibilities for integrating environmental considerations into public procurement, [2001] O.J. C333/12, and Interpretative communication of the Commission on the Community law applicable to public procurement and the possibilities for integrating social considerations into public procurement, [2001] O.J. C333/27. On these two communications, see Rhodri Williams, "The European Commission's Communication on the Environment and Public Procurement" (2002) 11 P.P.L.R. NA1 and "Commission Communication on Social Considerations" (2002) 11 P.P.L.R. NA53.

and Economic Committee. The Parliament also claimed that contracting authorities should be given the possibility of relying on non-economic award criteria, on condition that such criteria be non-discriminatory and comply with EC law. The judgment of the Court in the *Concordia Bus Finland* case,<sup>17</sup> more in line with the Commission's position, generated new amendments by the European Parliament,<sup>18</sup> aimed at overruling the case law.

#### 4. Secondary policies and the new public procurement Directives: very limited innovations

The results of the long and animated debate on the Commission's proposals are relatively modest, as far as secondary procurement policies are concerned. Very little substantial changes were made to the old Directives and to the initial proposals. The new Directives<sup>19</sup> are based on clarification of the existing law rather than on real innovations.

##### 4.1 The definition of the authorities' needs: technical specifications and special performance conditions

The first way that awarding authorities and entities may take into consideration general interest in their purchase policy is in the way they define the needs that the supplier, service provider or contractor is requested to fulfil. The purchase of supplies or services which are necessary for conducting a social policy, or the restriction on the entity's consumption of products which are not environment-friendly, are obvious ways of putting public procurement at the service of social or environmental aims.

The matter is, for a large part, governed by other legislative instruments, which, for instance, set rules on the access of the public to public buildings, oblige contracting authorities and entities to offer certain services, and require them to follow certain environmental assessment procedures before deciding the construction of large infrastructures. Nevertheless, the new Directives encourage awarding authorities and entities to lay down technical specifications so as to take into account the needs of all users and, in particular, disabled people. They allow awarding entities that wish to define environmental requirements for the technical specifications of a given contract, to lay down the environmental characteristics of the products or services such as their environmental effect or their production method. When so doing, awarding authorities may use specifications that are defined in eco-labels, such as the European Eco-label.<sup>20</sup> Of course, technical specifications shall not be discriminatory. For instance, the Commission has indicated that whereas a contracting authority or entity may request electricity to be produced from renewable energy sources, it cannot be required that the electricity be produced from wind only. Another example could be the requirement for the use of recycled materials.

<sup>17</sup> Case C-513/99 *Concordia Bus Finland Oy Ab v Helsingin kaupunki and HKL-Bussiliikenne* [2002] E.C.R. I-7213.

<sup>18</sup> See, in particular, amendments 70 and 95 to the proposal for the new Public Sectors Directive, Parliament's resolution of July 2, 2003 not yet published in the *Official Journal*.

<sup>19</sup> Directive 2004/.../EC of the European Parliament and of the Council of February 2, 2004 on the co-ordination of procedures for the award of public works contracts, public supply contracts and public service contracts [2004] O.J. L.../.. (the new Public Sectors Directive) and Directive 2004/.../EC of the European Parliament and of the Council of February 2, 2004 co-ordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors [2004] O.J. L.../.. (the new Utilities Directive).

<sup>20</sup> Recital 29 of the new Public Sectors Directive.

However, it is often very difficult to assess which of the possible alternative products is the most environmentally-friendly. This requires a life-cycle analysis, from cradle (production) to grave (disposal). According to the industry, very little data is available, which makes life-cycle assessment difficult and comparisons virtually impossible. Except in cases where an Eco-label has been put into place,<sup>21</sup> companies may be expected to challenge these types of technical specifications that will exclude them from the market.

Moreover, the reference to production methods is rather difficult to interpret. It results from amendments by the Parliament. The Commission considered that these amendments were in line with its interpretation of the existing Directives, but it is not clear that the intention of the Parliament and of the Council was to give to this reference a restrictive meaning. In fact, the new texts are not free of ambiguity. On the one hand, pursuant to Annex VI of the new Public Sectors Directive and Annex XXI of the new Utilities Directive, technical specifications are defined as characteristics required of a material, product supply or service, which permits this material, product, supply or service to fulfil the use for which it is intended by the contracting authority or entity. This seems to mean that, at least with regard to supply and to materials used for the realisation of works and the provision of services, the production methods are relevant only if they have an impact on the use of the product, services or works by the contracting authority or entity. An administration could require that foodstuff originate in biological agriculture, in so far as this would be the only way to avoid pesticides residues, for instance. In fact, this will be very seldom the case. Even in the case of electricity produced from renewable energy sources, which is used as an example by the Commission, the electricity which is supplied is not physically different from electricity produced from nuclear fuel or coal. On the other hand, the reference to Eco-labels, which are based on a life-cycle analysis, implies that the environmental impact of the product or service before it is used by the contracting authority is taken into account. Because of these ambiguities context, adopting "green" technical specifications is likely to create an additional legal risk in award procedures.

The performance of public contracts is governed by rules, which are distinct from the public procurement Directives, in particular in the social field. However, the new Directives formally recognise the possibility for the contracting authority or entity to lay down special conditions relating to the performance of the contract,<sup>22</sup> which is a way to obtain more than merely the goods, services or works which are the subject-matter of the contract.

The old Directives simply provided for the possibility of incentives to subcontracting, which is deemed to be favourable to small and medium companies. These provisions are maintained in the new Directives: awarding authorities may ask tenderers which part of the contract they envisage to subcontract and the proposed subcontractor.<sup>23</sup> They may even request works concessionaires to subcontract up to 30 per cent of the works.<sup>24</sup> In *Beentjes*, the Court admitted that, much more generally, contracting authorities were allowed to impose special conditions for the performance of the contract. The Court considered that a Dutch awarding authority was allowed to exclude from the award procedure a bidder that had submitted a bid which did not comply with the condition for the employment of unemployed workers for the performance of the contract, a requirement that was

<sup>21</sup> The European Eco-label is based on the life-cycle analysis approach, see Regulation 1980/2000/EC of the European Parliament and of the Council of July 17, 2000 on a revised Community eco-label award scheme, [2000] O.J. L237/1.

<sup>22</sup> Recital 33 and Art.26 of the new Public Sectors Directive; Recital 44 and Art.38 of the new Utilities Directive.

<sup>23</sup> Article 25 of the new Public Sectors Directive and Art.25 of the new Utilities Directive.

<sup>24</sup> Article 60 of the new Public Sectors Directive.

published in the contract notice. The new Directives confirm the possibility to impose such conditions. They may be related, in particular, to social or environmental considerations. The Directives cite various examples such as the requirement to recruit long-term job-seekers or to implement training measures. These provisions intend to give clarification to existing law, confirming the Commission's interpretation of the old Directives.

Contrary to the rules prevailing with respect to award criteria (see below), there is no need for such conditions to be related to the subject-matter of the contract. This is a way of tying the purchase of what is the subject-matter of the contract with something else, such as vocational training services. These conditions must be non-discriminatory and comply with other rules of EC law. However, they necessarily have a restrictive effect (and, in fact, their very reason is to have such an effect). It is submitted that for such specific conditions to be compatible with the EC Treaty, their restrictive effect must be proportionate to their expected contribution to their objective of general interest. Moreover, according to the Commission, contracting authorities and entities may not require that such conditions be fulfilled at the time of submitting the application to participate or the bid.<sup>25</sup> This is a way to avoid discrimination. However, it may not be easy for a contractor to recruit a significant number of unemployed or disabled people for the performance of a given contract and it may be difficult to conclude labour contracts for a limited duration or to dismiss employees who do not belong to a targeted group defined by the contracting authority or entity in order to replace them by others. Again, the necessity to avoid discrimination and disproportionate restrictions to trade require contracting authorities and entities to be very careful when resorting to the possibility opened by the Directives.

#### 4.2 Applicable procedures

As a matter of principle, the choice of the award procedure should normally not be affected by the policy objectives of the awarding entity. However, in reality, the Directives do not completely ignore the policy context of the contract. First, as in the old Public Works Directive, an exceptional flexibility is admitted for the selection of architects who are to be involved in social housing schemes.<sup>26</sup> Secondly, some services which are especially sensitive from a cultural and social point of view are listed in Annex IIB of the Public Sectors Directive and in Annex XVIIB of the Utilities Directive, and are therefore excluded from the full application of these Directives (for instance, Education and vocational education services, Health and social services and Recreational, cultural and sporting services). This exclusion allows awarding entities to choose freely the award procedure they wish to apply. Contracts for the purchase, development, production or co-production of broadcasting programmes are even fully excluded from the scope of application of the two Directives, on the grounds that for these kinds of contracts, it must be possible to take into account aspects of cultural or social significance.<sup>27</sup>

On these two issues, no amendment was proposed and the regime resulting from the old Directives remains unchanged.

<sup>25</sup> Interpretative communication on the Community law applicable to public procurement and the possibilities for integrating environmental considerations into public procurement, n.16 above at point 4 and Interpretative communication of the Commission on the Community law applicable to public procurement and the possibilities for integrating social considerations into public procurement, n.16 above, at point 1.6.

<sup>26</sup> Article 34 of the new Public Sectors Directive.

<sup>27</sup> Recital 25 of the new Public Sectors Directive.

### 4.3 Selection of candidates

The Directives allow contracting authorities and entities to select economic operators on the basis of their reliability, financial and economic standing and technical and professional capacity. Selection may be founded only on these grounds: therefore, a preference in favour of economic operators established in certain regions, for instance, is contrary to the Directives.<sup>28</sup> Moreover, whereas the information concerning economic and financial standing is not listed exhaustively, contracting authorities may not require the production of information concerning potential exclusion grounds and technical and professional capacity other than those listed in the Directives.<sup>29</sup>

These principles have been significantly affected by the reform. Reservation of contracts makes a notable appearance in European public procurement law with a possibility to reserve contracts to sheltered workshops or sheltered employment programmes.<sup>30</sup> This is going much further than performance conditions. It is a bit odd that only entities employing disabled people benefit from this new provision, whereas other entities, which were favoured by certain national laws, are not given similar privileges. For example, associations or companies which employ long-term unemployed people, with the objective of training them and giving them the possibility of re-entering the labour market, also face difficulties with competitiveness.

The new Directives also innovate by making it an obligation for awarding authorities to support the European criminal policy. Under the old Directives, contracting authorities already had the possibility to exclude from participation in the procedure for the award of a contract any company with doubtful professional morality. This possibility is justified by the consideration that such a company is not reliable. Now, contracting authorities *must* not, except in specific circumstances, contract with economic operators which have been convicted for serious criminal offences relating to organised crime, corruption, fraud and money laundering. (This prohibition does not apply to contracting entities governed by the Utilities Directive that are not contracting authorities.<sup>31</sup>) It may be admitted that the tenderers which are excluded on the basis of these new provisions are especially unreliable, but the real consideration for this amendment is the struggle against these forms of criminality.

The new Directives also indicate that contracting authorities may exclude candidates or tenderers which have been convicted for infringement to rules relating to working conditions or the protection of the environment or have been guilty of grave professional misconduct in this field, if national legislation contain provisions to that effect. This confirms the Commission's interpretation of the old Directives. It cannot be doubted that all infringement of such rules are related to the professional conduct of the legal or natural person concerned. However, it must not be forgotten that the aim of the provisions of the Directives on the selection of candidates or tenderers is to exclude companies which are not reliable or even to select the ones that are the most reliable. From this point of view, it is significant to note the fate of amendments proposed by the European Parliament. These favoured extending the prohibition on contracting to companies that breached collective work agreements and extending the possibility of excluding tenderers or candidates to companies that infringed rules relating to workers' health and safety. However, these amendments have been rejected. In this context, it seems that, more than the seriousness of the offence or misconduct with regard to the objectives of the infringed rules (the protection of the environment or the health of workers, for

<sup>28</sup> Case C-360/89 *Commission v Italy*, n.2 above.

<sup>29</sup> Case 76/81 *Transporoute v Minister of Public Works* [1982] E.C.R. 417.

<sup>30</sup> Article 19 of the new Public Sectors Directive and Art.28 of the new Utilities Directive.

<sup>31</sup> Article 45(1) of the new Public Sectors Directive and Art.53(3) of the new Utilities Directive.

instance), Member States and contracting authorities will have to assess the impact of the behaviour in question on the reliability of the company concerned. Indeed, the new provisions must be read in conformity with the principle of proportionality, and the exclusion of tenderers or candidates must be justified by their lack of reliability.

Finally, the Directives define, as before, the documents that contracting authorities and entities may require from economic operators to assess their technical, financial and economic capacity. Concerning technical capability, the Directives now make clear that in the case of works and services contracts, contracting authorities may request the economic operator to give an indication of the environmental management measures that it will be able to apply when performing the contract.<sup>32</sup> In this case, EMAS certification, or certification with relevant European or international standards may be required, but equivalent certificates established by bodies in other Member States must be accepted.<sup>33</sup> The limitation of the possibility for requiring this type of indication to certain service and works contracts does not seem to be consistent with, for example, the possibility for special performance conditions relating to environmental requirements, which are also relevant to supply contracts. More generally, although contracting authorities may impose special performance conditions, they do not seem to be allowed to require information concerning the capacity of economic operators to comply with such conditions. For instance, no information may be requested concerning the organisation of on-site vocational training, which is one of the examples of possible special performance conditions given in the recitals of the Directives. It is understandable that the Community legislator was reluctant to extend the information that may be requested from economic operators and therefore to increase the difficulty for companies to be candidates or submit a tender. However, this is a serious inconsistency.

#### 4.4 Choice of bids

Contracting authorities or entities may choose to award the contract to the lowest bid, or to the economically most advantageous one. Provisions relating to preference schemes in the field of public works contracts, which were included in Directive 93/37, have been deleted on the grounds that they were either contrary to the case law of the European Court of Justice, or outdated.<sup>34</sup>

Under the old Directives, the European Court of Justice held that the award criteria on which contracting authorities or entities may rely if they choose the most economically advantageous bid as the basis for the award, were not exhaustively enumerated by the Directives.<sup>35</sup> However, these criteria must be aimed at finding the economically most advantageous bid.<sup>36</sup> On these grounds, the Commission considered that criteria which were not related to the economic or technical value of the bid could not be used. Quite curiously, in *Commission v France*, the Court held that, because performance conditions such as those in *Beentjes* could lead to an exclusion of a bid, it could not be argued that additional award criteria were prohibited. In fact, this seems to reflect a confusion in

<sup>32</sup> Article 48(2)(f) of the new Public Sectors Directive and Art.52(3) of the new Utilities Directive.

<sup>33</sup> Article 50 of the new Public Sectors Directive and Art.52(3) of the new Utilities Directive.

<sup>34</sup> See the Proposal for a directive of the European Parliament and of the Council on the co-ordination of procedures for the award of public supply contracts, public service contracts and public works contracts, cited above, n.14, analysis of Art.53.

<sup>35</sup> Case 31/87 *Beentjes v Netherlands State*, n.9 above and Case C-19/00 *SIAC Construction Ltd v County Council of the County of Mayo* [2001] E.C.R. I-7725.

<sup>36</sup> Case 31/87 *Beentjes v Netherlands State*, n.9 above, Case C-19/00 *SIAC Construction Ltd v County Council of the County of Mayo*, n.35 above and Case C-513/99 *Concordia Bus Finland Oy Ab v Helsingin kaupunki and HKL-Bussiliikenne*, n.17 above.

vocabulary between award criteria used to rank the bids according to their interest, and the requirement that a bid conforms with the contract specifications. The Commission tried to include this judgment in the framework of its interpretation of the Directives and claimed that the solution was based on the fact that the additional criterion at stake was to be used only in order to compare economically and technically equivalent bids. However, in *Concordia Bus Finland*, the Court held that award criteria should be related to the subject-matter of the contract, and this was not the case in *Commission v France*.

The new Directives are based on the most recent case law of the Court and aim at clarifying this issue. They explicitly indicate that in order to guarantee equal treatment, the criteria for the award of the contract should enable tenders to be compared and assessed objectively.<sup>37</sup> Criteria must be relevant to determining the most economically advantageous bid from the point of view of the contracting authority and they must be linked to the subject-matter of the public contract in question. Under these conditions, these criteria may be related to the protection of the environment or to social policies, for instance.<sup>38</sup> An example would be the criterion of the accessibility of a public building to disabled people. This seems to exclude additional criteria which are not related to the subject-matter of the contract, even if the compared bids are economically equivalent.

Although much more discreetly, it seems that the rules on abnormally low tenders, which allow contracting authorities to derogate to exclude the lowest or the apparently economically most advantageous tender, have been significantly amended. The Directives now make clear that a bid may be considered as being abnormally low because it is based on non-compliance with social legislation, for instance.<sup>39</sup> This was already the case under the old Directives, since such a breach of applicable legislation implies that in the case of enforcement of the rules concerned by the competent authorities, the supplier, service provider or contractor may not be capable of performing the contract under the agreed terms.<sup>40</sup> But the new Public Sectors Directives innovates with respect to the issue of State aids. In *ARGE*, the European Court of Justice held that contracting authorities were not obliged to exclude bids based on illegal State aids. The Court pointed out that contracting authorities may exclude a tenderer if it results from its replies to the authority's enquiry that the bid based on illegal State aid and that the obligation of restitution of such aid may create a risk regarding the financial standing of the company concerned.<sup>41</sup> It seems that the new Public Sectors Directive not only confirms this case law, but also goes further. According to Art.54(3) of this Directive, contracting authorities may exclude abnormally low tenders which are based on State aids if the tenderer is not able to demonstrate that the State aid was granted legally; contracting authorities have no obligation to examine whether the potentially illegal character of the aid might jeopardise the performance of the contract. In fact, contracting authorities are kindly invited to support the European competition policy.

<sup>37</sup> Recital 46 of the new Public Sectors Directive and Recital 55 of the new Utilities Directive.

<sup>38</sup> Article 53 of the new Public Sectors Directive and Art.55 of the new Utilities Directive.

<sup>39</sup> Article 55(1)(d) of the new Public Sectors Directive and Art.57(1)(d) of the new Utilities Directive.

<sup>40</sup> See the amended proposals, COM (2002) 235 final and COM (2002) 236 final, May 6, 2002.

<sup>41</sup> Case C-94/99 *ARGE Gewässerschutz v Bundesministerium für Land-und Forstwirtschaft* [2000] E.C.R. I-11037, point 30.

#### 4.5 Advertising of contracts

Rules concerning the advertising of contracts are the cornerstone of the EC Public Procurement Directives. Whereas other rules of the Directives have been interpreted relatively flexibly, or have been adapted in order to allow awarding entities to take into account secondary policies, advertising rules should remain very strict.

The information that must be made available to candidates and tenderers has been made more complete. The old service and works Directives provided that Member States were allowed to require awarding entities to indicate in the contract documents the body or bodies from which information on the obligations relating to employment protection and working conditions applicable in the country may be obtained. Member States may now also require their awarding authorities to supply the same kind of information concerning taxes and the legislation concerning environmental protection.<sup>42</sup> In this case, the awarding authority requests tenderers to indicate that they have taken these obligations into account. This may also be a way of integrating the compliance with certain national rules into contract conditions.

More generally, it is precisely the extensive character of advertising rules that allows flexibility in the definition of specific conditions, selection of companies and award of contracts. In *Beentjes*, the Court held that performance conditions like those of the contract in this case had to be published. In *Commission v France*, the Court even considered that, because the contested criteria had been published, the Commission's claim that France had infringed the Works Directive was unfounded. (Nevertheless, as we have seen above, it is difficult to reconcile this case with *Beentjes* and *Concordia Bus Finland*). The new Directives confirm this obligation of transparency by requiring, depending on the circumstances, an indication in the contract notice or in the contract documents.

However, companies may use the information that awarding authorities have the obligation to make public, only if this information is effectively and easily accessible. Although the situation may change in the future thanks to the development of the access to contract documents through electronic means, an indication in the contract documents is not equivalent to a publication in the Official Journal. As the Court held in *Beentjes*, it is necessary that potential candidates or tenderers may be immediately informed whether they are interested in a contract, and this requires certain elements of information to be mentioned in the contract notice. Whereas the reservation of contracts to sheltered workshop or sheltered employment programmes must be mentioned in the contract notice, this is not the case of special conditions for the performance of a contract or award criteria relating to social or environmental policies or to similar secondary policies, which may simply be mentioned in the contract documents.

## 5. Conclusion

Contracting authorities and entities are not completely free in the choice of means they can use in order to take into account "public concerns" in their procurement. The new Directives make very limited amendments to the former state of Community law. Most of the new provisions are attempts at clarification of the existing texts and confirmation of the case law, or at least of its interpretation by the EC co-legislators.

<sup>42</sup> Article 27 of the new Public Sectors Directive and Art.39 of the new Utilities Directive.



However, Community legislation and the Court of Justice have already gone very far and, in reality, there are very few techniques that are by themselves contrary to the Directives. Contracting authorities and entities may take into account environmental and social considerations, on which the emphasis has been put during the recent years, but also other objectives like competition policy or support for subcontracting.

One may fear that, in particular in the absence of stricter advertising rules, the broad possibilities opened by the Directives might lead to less transparency in the public procurement market and to a division of this market due to a difference in policy preferences of contracting entities of the European Union. Nevertheless, the use of all the techniques, which are allowed, is subject to a general condition: they must not be discriminatory and they must comply with the other rules of EC law. This implies a case-by-case analysis of contract specifications, special performance conditions, award criteria and grounds for exclusion from participation in a procedure. Such an analysis will very often be rather delicate and it is not clear that the new Directives really guarantee greater legal certainty than the old ones. In this context, it may be thought that contracting authorities which choose to implement secondary procurement policies may well expose themselves to legal challenge.<sup>43</sup> Encouraging these types of procurement policies is indeed a very strange way of promoting the simplification and clarification of public contracts law.

<sup>43</sup> Concerning the deterrent effect of legal uncertainty in this field, see the Commission's communication on Public Procurement. Regional and social aspects, n.10 above, at point 63.

# Defence Procurement: The New Public Sector Directive and Beyond

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## 1. Introduction

Defence and security have featured prominently on the European agenda recently. Since 1998, the EU has been developing an autonomous military capacity for peacekeeping and other crisis management missions. The inclusion of a mutual defence commitment in the 2003 Draft Constitutional Treaty might soon turn the Union into a veritable military alliance. Defence procurement, understood as the entirety of purchasing activities for the armed forces, is a crucial part of the development of a European defence identity. Europe needs to overcome a substantial capabilities gap and this will require major acquisitions of new equipment. The Member States have a combined defence budget of about two thirds of that of the United States but they are not capable of any major operation without drawing on NATO assets.<sup>1</sup> Rather than increasing defence budgets, there is a move towards rationalisation by integrating efforts. Most of these activities are conducted within intergovernmental frameworks: the European Defence and Security Policy (EDSP) as part of the Common Foreign and Security Policy (CFSP) of the EU, the Western European Armaments Group (WEAG) of the fading Western European Union (WEU), or the Organisation of Joint Armaments Co-operation (OCCAR). However, defence procurement is not completely excluded from the application of the supranational Community pillar of the Treaty on European Union.

At the moment, procurement conducted by the ministries of defence of the Member States is only partly covered by the public sector directives. The procurement of “civil” goods, services, and works are clearly covered. Also covered are the “dual-use goods”, sometimes referred to as “soft defence material”: products, which can be used for both civil and military purposes. Hard defence material, in other words weapons or armaments, are automatically excluded from the application of the current Supplies Directive. The wording of the relevant provision in the new Public Sector Directive,<sup>2</sup> however, supports the interpretation that armaments are no longer categorically excluded.

The purpose of this article is to provide a discussion of European defence procurement today. Due to various recent and imminent changes, the year 2004 is an appropriate date to address the topic. Within the next two years, the Member States have to implement a new Public Sector Directive. Therefore, an analysis of the relevant provisions of the new Directive occupies the larger part of the article. The remainder provides an overview of actual and potential defence procurement activities

<sup>1</sup> This figure of EU External Relations Commissioner Chris Patten is subject to disagreement. The Centre for European Reform argues that the combined annual defence budgets of the EU Member States is about half that of the USA. The latter spends about US\$290 billion annually. The defence budgets of the EU Member States have declined by 22 per cent in real terms 1992–2001. See: S. Duke, “CESDP: Nice’s Overtrumped Success?” (2001) 6 *European Foreign Affairs Review* 155, at 164.

<sup>2</sup> Ref required.

beyond the Community pillar of the TEU, including the proposal of the European Convention to establish a European Armaments Agency.<sup>3</sup>

## 2. The new Public Sector Directive

Similar to the current Supplies and Services Directives, the new Public Sector Directive (hereinafter “the new Directive”) contains a number of provisions relevant to defence procurement. These provisions represent exemptions from the application of the Directive.

### 2.1 Article 10 and armaments

Article 10 of the new Directive refers directly to defence procurement under a heading with that name:

“This Directive shall apply to public contracts awarded by contracting authorities in the field of defence, subject to Article 296 of the Treaty.”

The purpose of the first half of the provision is to clarify the application of the Directive to activities of the “contracting authorities in the field of defence”. Moreover, Annex I of the Directive lists the ministries of defence and defence procurement agencies of the Member States amongst the contracting authorities covered by the Directive. In this regard, the new Directive follows the tradition of the current Supplies and Services Directives.

The wording of the second half of the provision, however, is new and its interpretation is complex. It is submitted that the meaning of Art.10 of the new Directive depends mainly on the interpretation of Art.296 EC. Moreover, a comparison with the wording of corresponding provisions in the current Supplies and Services Directives will also facilitate the interpretation.

#### 2.1.1 Article 296(1)(b) EC

Article 296(1)(b) EC allows a Member State “to take such measures as it considers necessary for the protection of the essential interests of its security which are connected with the production of trade in arms, munitions and war material”.<sup>4</sup> In 1958, the Council drew up a list of products to which this provision applies according to Art.296(2) EC.<sup>5</sup> The list has never been officially published but is part of the public domain.<sup>6</sup> In late 2001, the Council provided a version of the list in response to the written question in the European Parliament.<sup>7</sup> It includes classical military material such as tanks, fighter aircraft and warships, including highly sensitive equipment such as nuclear weapons. The

<sup>3</sup> Beyond the POLARM forum within the EU, European defence procurement and industrial reform is discussed in: the Conference of National Armaments Directors (CNAD) of NATO, the Western European Armaments Group (WEAG) and the Western European Armaments Organisation (WEAO) of the Western European Union (WEU), the Organisation of Joint Armaments Co-operation (OCCAR) and the Letter of Intent (LOI) forum.

<sup>4</sup> For a detailed analysis of Art.296(1)(b) EC see: M. Trybus, “The EC Treaty as an instrument of European defence integration: judicial scrutiny of defence and security exceptions” (2002) 39 C.M.L.Rev. 1347, at 1352–1362.

<sup>5</sup> Council Decision 298/58 of April 15, 1958 (not published). There have been no amendments to the list since 1958.

<sup>6</sup> For a copy of the list, see: A. Courades Allebeck, “The European Community: from the EC to the European Union” in *Arms Industry Limited* (H. Wulf ed., OUP, Oxford, 1993), p.214; M. Trybus, *European Defence Procurement Law: International and National Procurement Systems as Models for a Liberalised Defence Procurement Market in Europe*, (Kluwer Law International, The Hague/London/Boston, 1999), pp.14–15 (hereinafter “Models”).

<sup>7</sup> (2003) 12 P.P.L.R. NA15–21.

application of Art.296(1)(b) is strictly limited to the material on the list,<sup>8</sup> which can also be called warlike or hard defence material.

Member States have interpreted Art.296(1)(b) EC as an automatic exclusion of hard defence material from the application of the Treaty<sup>9</sup> but the Commission argued for a narrow interpretation.<sup>10</sup> In *Commission v Spain*<sup>11</sup> the Court clarified the situation. An EC directive subjects all imports to VAT. Spain had justified the exemption of arms imports from VAT by Art.296(1)(b) EC. There is a general rule that all exemptions from the Treaty have to be interpreted narrowly to avoid a detrimental effect on the functioning of the internal market as a whole.<sup>12</sup> This narrow interpretation involves the application of a proportionality test. A Member State measure has to be suitable and necessary to serve a public interest, for example, security. The interest of security is balanced with the interest of the internal market. On the basis of this rule, the Court in *Commission v Spain* applied a narrow interpretation of Art.296(1)(b) EC. Member States have to invoke the exemption and have the burden of proof that its requirements are met. On this general basis, the Court ruled that:

“In the present case, [. . .] Spain has not demonstrated that the exemptions provided for by the Law [of 1987] are *necessary* for the protection of the essential interests of its security. [. . .]. It follows that the VAT exemptions are not *necessary* in order to achieve the objective of protecting the essential interests of the security of [. . .] Spain”.<sup>13</sup>

On the one hand, this narrow interpretation ensures the Community interests in the internal market in relation to measures taken for national security reasons connected to armaments. On the other hand, the national security interests of the Member States are also accommodated as they are left a wide margin of appreciation. However, *Commission v Spain* was a clear case. In other cases, the Court is likely to be more careful. The proportionality test allows balancing the internal market interests with the national security interests of the Member States. It is of essential

<sup>8</sup> See, for example, R. M. Wessel, *The European Union's Foreign and Security Policy: A Legal Institutional Perspective* (Kluwer Law International, The Hague/London/Boston, 1999), p.312. On the discussion on the applicability of Art.296(1)(b) EC to dual use goods, see: K. Eikenberg, “Article 296 (ex 223) E.C. and external trade in strategic goods” (2000) 25 E.L.Rev. 117, at 125–128, who advocates that the provision does not apply to dual use goods. See also, O. Lhoest, “La production et la commerce des armes, et l'article 223 du traité constituant la Communauté européenne” (1993) 1 *Revue belge de droit international* 176, at 184–185; S. Arrowsmith, *The Law of Public and Utilities Procurement* (Sweet & Maxwell, London, 1996), pp.858–859; and J. B. Wheaton, “Defence Procurement and the European Community: The Legal Provisions” (1992) 1 P.P.L.R. 432, at 434, W. Hummer, “Artikel 223” in *Kommentar zum EWGV* (E. Grabitz and M. Hilf eds., C. H. Beck Verlag, Munich, 1997) looseleaf, volume II, Art.223, at para.12.

<sup>9</sup> This opinion has been put forward by the respective Member States in many cases before the European Court of Justice. See, for example, the United Kingdom in Case C-222/84 *Marguerite Johnston v Chief Constable of the Royal Ulster Constabulary* [1986] E.C.R. 1651, at 1671:

“The EEC Treaty itself leaves intact the power of the Member States to take such measures as they may consider necessary or expedient for the above mentioned purposes [safeguarding national security or for protecting public safety or public order] as is shown by the ‘safeguard clauses’ contained in Articles 36, 48, 66, 223 and 224 [now 30, 45, 55, 296 and 297]”.

Or a French Government publication: *La notion de sécurité en droit européen*, ministère de la défense, secrétariat général pour l'administration, direction des affaires juridiques (DAJ), études juridiques No. 17, September 1999 at 7.

<sup>10</sup> In particular, the Commission was in favour of a more limited application: *The Challenges Facing the European Defence-Related Industry*, COM (96) 10 final, at 14. For an earlier elaboration of this position see, S. Arrowsmith, above n.00, at 861–863.

<sup>11</sup> Case C-414/97 [1999] E.C.R. I-5585; [2000] 2 C.M.L.R. 4. See also, M. Trybus “On the Application of the E.C. Treaty to Armaments” (2000) 25 E.L.Rev. 633; (2000) 9 P.P.L.R. NA99.

<sup>12</sup> Case C-222/84 *Johnston*, above n.9, at para.26; Case C-13/68 *SpA Salgoil v Italian Ministry of Foreign Trade* [1968] E.C.R. 453, at 463; [1969] C.M.L.R. 181, at 192.

<sup>13</sup> Case C-414/97, above n.11, at para.22, emphasis added.

significance for the interpretation of the hard defence exemption in the current and new Directives. Article 10 of the new Directive appears to accommodate *Commission v Spain*. It is not an automatic exemption like its predecessor in the current Supplies Directive. It needs to be invoked and justified alongside Art.296(1)(b) EC and the Court will subject its use to scrutiny, including the application of a proportionality test.

### 2.1.2 *The current armaments exemptions*

The contrasting wording of the current Supplies and Services Directives confirms this interpretation of Art.10 of the new Directive. Art.3 of the Supplies Directive reads:

“[...] this Directive shall apply to all products [...] including to those contracts awarded by contracting authorities in the field of defence except for the *products* to which Article 223(1)(b) [now 296(1)(b)] of the EEC Treaty applies [emphasis added].”

The reference to “products to which Art.296(1)(b) EC applies” makes this provision an automatic exclusion of all armaments on the list of 1958. Article 4(1) of the Services Directive is a similar provision:

“This Directive shall apply to public service contracts awarded by contracting authorities in the field of defence, except for *contracts* to which the provisions of Article 223 [now 296] of the Treaty apply [emphasis added].”

Article 4(1) of the Services Directive, which excludes “*contracts* to which the provision of Art.223 [now 296] of the Treaty apply”, differs from Art.3 of the Supplies Directive which excludes “*products* to which the provision of Art.296(1)(b) [EC] apply”. A detail supporting this interpretation is that the provision in the Supplies Directive refers specifically to Art.296(1)(b) EC which concerns products. The provision in the Services Directive, on the other hand, refers to “the provisions of Art.296”, including Art.296(1)(a) EC.<sup>14</sup> It has always been clear that Art.296(1)(a) EC has to be specifically invoked by the Member State who wishes to rely on it. Article 3 of the Supplies Directive refers only to s.(1)(b) of Art.296 EC, which at the time was the part of Art.296 EC interpreted as an automatic exclusion from the Treaty. This is a strong indication that Art.3 of the Supplies Directive constitutes an automatic exclusion of hard defence material. This means that national defence procurement authorities do not have to follow the current Supplies Directive when procuring a piece of hard defence equipment, such as a warship or a tank.

The provision of the Services Directive, when based on the interpretation of Art.296(1)(b) EC provided by the Court in *Commission v Spain* outlined above, does not necessarily constitute such a wide exclusion. Service *contracts* involving hard defence material still have to be advertised and procured on the basis of the rules of the Directive, unless a Member State invokes Art.296(1)(b) EC, via Art.4(1) of the Services Directive, for security reasons. This means that, normally, a national defence procurement authority must follow the Directive when procuring a service related to hard defence material. An earlier draft of the new Directive followed the wording of the Services Directive.<sup>15</sup> Article 10 of the current version of the new Directive refers to neither contracts nor

<sup>14</sup> Article 296(1)(a) EC reads: “no Member State shall be obliged to supply information, the disclosure of which it considers contrary to the essential interests of its security”.

<sup>15</sup> *Proposal for a Directive of the European Parliament and the Council on the coordination of procedures for the award of public supply contracts, public service contracts and public works contracts (presented by the Commission)*, May 10, 2000, COM (2000) 275 final. Article 7 of this Draft Proposal reads: “This Directive shall apply to public contracts awarded by contracting authorities in

products but merely to Art.296 EC. Similar to the current Services Directive and in contrast to the current Supplies Directive, Art.10 refers to the entire Art.296 EC. These are indications that Art.10 of the Directive is no automatic exemption.

Three important questions emerge from this interpretation.

The first question is how widely accepted the interpretation will be once the Directive is implemented. If procurement officers, policy makers, the Commission, and the legal community interpret Art.10 as an automatic exclusion of hard defence material from the application of the new Directive, little will change. The fact that the defence procurement authorities of the Member States have not changed their procurement practices in relation to hard defence material during the (more than) four years since the judgment in *Commission v Spain* is an indication for their understanding of Art.10. As Art.3 of the current Supplies Directive is an automatic exclusion from the Directive, they do not have to follow the Directive when buying armaments. However, they have to follow the Treaty, unless they can invoke Art.296(1)(b) EC. The Treaty imposes positive obligations on procurement authorities, for example, in relation to award procedures.<sup>16</sup> European defence procurement authorities did not change their practices after *Commission v Spain* and treat both Art.3 of the Supplies Directive and Art.296(1)(b) EC as automatic exclusions. An automatic exclusion has obvious advantages. It is clear and therefore easy to understand and use. In comparison, the exclusion within the limits of proportionality, however wide the margin of appreciation of the Member States, has disadvantages. Proportionality might be difficult to assess thereby introducing an element of uncertainty. The requirement “to invoke and prove” imposes an additional burden on the Member States thereby making the exclusion less user-friendly.

A second and related question is, whether the requirements of the new Directive and the Treaty in relation to hard defence material will be followed in practice. Will the Member States invoke Art.296(1)(b) EC and prove detrimental effects on their national security interest forcing them to derogate from the new Directive? The effect, in practice, will depend on the acceptance of the Member States, the attitude of the Commission to enforcement, the readiness of the court to review these cases, and the intensity of scrutiny applied. Until 1999, Art.296(1)(b) EC was widely understood as an automatic exclusion. The interpretation in *Commission v Spain* is a relatively recent development. There will be years before the implementation of the new Directive. It is too early to say whether the defence procurement authorities will operate on the understanding that they do have to follow the Directive and the Treaty in relation to hard defence material, unless they can justify derogation through Art.296(1)(b) EC.

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the field of defence, except for public supply and service contracts to which the provisions of Article 296 of the Treaty apply.” The wording of Art.7 in an amended version of the Draft Proposal put forward in April 2001 reads “This Directive shall apply to public contracts awarded by contracting authorities in the field of defence, subject to the provisions of Article 296 of the Treaty.” This version is already very close to the current version in Art.10. However, the April 2001 version of Art.7 is clearer on the inclusion of Art.296(1)(a) EC, although it is submitted that it is also included in the current Art.10.

<sup>16</sup> Case C-275/98 *Unitron Scandinavia A/S, 3-S A/S, Danske Svineproducenters serviceselskab v Ministeret for Fodvaer, Landbrug og Fiskeri* [1999] E.C.R. I-8291, at para.31; Case C-324/98 *Telaustria Verlags GmbH und Telefonadress GmbH v Telekom Austria AG* [2000] E.C.R. I-10704. The contract was not covered by the Directive because: “such a contract is excluded, [...] by reason of the fact, in particular, that the consideration provided by the first undertaking to the second consists in the second obtaining the right to exploit for payment its own service.” See annotations by M. Dischendorfer, “Service Concessions under the EC Procurement Directives: A Note on the Telaustria Case “ (2001) 10 P.P.L.R. NA57. On the requirements of the Treaty in relation to procurements outside the application of the directives in detail, P. Braun, “A Matter of Principle(s)—The Treatment of Contracts Falling Outside the Scope of the European Public Procurement Directives” (2002) 9 P.P.L.R. 39.

The narrow interpretation of Art.10 might lead to the application of the new Directive to the procurement of hard defence material. This leads to the third and final question: does the new Directive represent a suitable instrument for the procurement of armaments? The less suitable the Directive for defence procurement, the more likely the use of Art.10 to accommodate the concerns that might make the Directive unsuitable. Defence procurement has special characteristics that differentiate it from civil purchasing. Defence procurement agencies have to operate in a politically sensitive environment, dominated by national security and secrecy concerns. The government is normally the only client of its national defence industry. Sophisticated and *advanced* equipment is expensive but can offer decisive advantages in relation to both deterrence and actual warfare.<sup>17</sup> A comprehensive analysis of the new Directive with regards to its suitability for defence procurement goes well beyond the aims of this paper.<sup>18</sup> Suffice it to point out that the decision-makers, at least those in Council and Parliament, seem to understand Art.296(1)(b) EC as an automatic exclusion. This makes it very unlikely that they had the aim to create an instrument suitable for the procurement of armaments.

## 2.2 Other exemptions: Articles 14 and 15

The other provisions potentially relevant to defence procurement, most notably the secrecy and security exemption in Art.14<sup>19</sup> and the international agreement exemption in Art.15,<sup>20</sup> remain unaltered in the new Directive.

<sup>17</sup> On European defence procurement, see: Trybus, "Models", above n.6; A. Cox, "The Future of European Defence Policy: The Case of a Centralised Procurement Agency" (1994) 3 P.P.L.R. 65; S. Walker and P. Gummert, "Nationalism, Internationalism and the European Defence Market", Chaillot Paper No.9, Institute for Security Studies of the Western European Union, Paris, September 1993; J. Wheaton, J. M. Buckworth and L. Ciantanni, "Developing Trends in the EC Defence Sector", Clifford Chance Paper, (unpublished); P. de Vestel, "Defence Markets and Industries in Europe; time for political decisions?", Chaillot Paper No.21, Institute of Security Studies of the Western European Union, Paris, November 1995, p.26; A. Cox and K. Hartley, "The Costs of Non-Europe in Defence Procurement-Executive Summary", The Commission of the European Communities D.G. III, July 1992.

<sup>18</sup> See Trybus, "Models", above n.6, ch.3 at 47-64 on the suitability of the current Directives for defence procurement.

<sup>19</sup> Article 14 of the new Directive reads:

"Secret contracts and contracts requiring special security measures. This Directive shall not apply to public contracts when they are declared to be secret, when their execution must be accompanied by special security measures in accordance with the laws, regulations or administrative provisions in force in the Member State concerned, or when the protection of the essential interests of that Member State so requires."

Similar exemptions are contained in the current Directives: Art.2 of the Supplies Directive, Art.4(2) of the Services Directive, Art.4(b) of the Works Directive and Art.10 of the Utilities Directive. The wording "when the protection of the essential interests of that Member State so requires" changes the wording of the current Directives and of previous drafts of the new Directive, (*Proposal for a Directive of the European Parliament and the Council on the coordination of procedures for the award of public supply contracts, public service contracts and public works contracts (presented by the Commission, May 10, 2000, COM (2000) 275 final*), which was "when the protection of the basic interests of the Member State's security so requires", see: M. Trybus, "Procurement for the Armed Forces: Balancing Security and the Internal Market" (2002) 27 E.L.Rev. 692, at 707-709 (hereinafter "Armed Forces"). *Prima facie* this new wording implies a wider exemption, as it does not even include the word "security". However, the "essential interests" have to be interpreted with a view of the heading "secret contracts and contracts requiring special security measures". Therefore, it is submitted that the "essential interests" have to be interpreted as "essential security interests", excluding interests that are not related to security. This interpretation is also supported by the fact that a wider concept of "essential interests" would be contrary to the EC Treaty, for example, Arts 30 or 55, 46 EC. Moreover, the notion "essential" limits the interests justifying exemption the same way as the notion "basic" in the current Directives: not all security interests justify exemption. Finally, the use of the exemption is subject to judicial scrutiny, including a proportionality test.

<sup>20</sup> Article 15 of the new Directive reads:

"Contracts awarded pursuant to international rules.

This Directive shall not apply to public contracts governed by different procedural rules and awarded:

### 3. European defence procurement beyond the Community and the new Directive

The possible future application of the new Public Sector Directive to the procurement of armaments cannot be seen in isolation. With regards to the Community, the European Commission has made comprehensive proposals regarding defence industrial and procurement issues.<sup>21</sup> Beyond the Community pillar of the TEU, defence procurement is an important part of a European armaments policy, which is a crucial element of the emerging EDSP of the EU. Last year's European Convention proposed a European Armaments Agency. Perhaps more importantly, organisational structures outside the EU have started to address the reorganisation and preservation of the European defence industrial base. The remainder of this article will cover activities within the context of the EU before discussing the initiatives of the WEU and OCCAR.

#### 3.1 The Draft Constitutional Treaty and the European Armaments Agency

The process of integration through the EDSP gained momentum after an autonomous EU military capability was proposed on the Franco-British Summit of Saint-Malo in December 1998.<sup>22</sup> In June 1999, the Cologne European Council turned the "Blair-Chirac" proposal into a European policy<sup>23</sup> and in June 2000, the Helsinki European Council established the "Helsinki Headline Goal" of a European Rapid Reaction Force of up to 60,000 by 2003.<sup>24</sup> So far, the creation of an EU "peacekeeping" capability has been the main focus of the EDSP. The current Nice version of the TEU of December 2000 does not contain any additional elements, for example, a European armaments policy. In July 2003, the European Convention presented a Draft Constitutional Treaty (hereinafter DCT),<sup>25</sup> which goes well beyond the *acquis* of Nice. However, in December 2003, the

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(a) pursuant to an international agreement concluded in conformity with the Treaty between a Member State and one or more third countries and covering supplies or works intended for the joint implementation or exploitation of a work by the signatory States or services intended for the joint implementation or exploitation of a project by the signatory States; all agreements shall be communicated to the Commission, which may consult the Advisory Committee for Public Contracts referred to in Article 77;

(b) pursuant to a concluded international agreement relating to the stationing of troops and concerning the undertakings of a Member State or a third country;

(c) pursuant to the particular procedure of an international organisation."

Similar exemptions are contained in the current Directives: Art.4 of the Supplies Directive, Art.5 of the Services Directive, Art.5 of the Works Directive, and Art.17 of the Utilities Directive. The wording remains the same. For details, see Trybus, "Armed Forces", *op. cit.*, at 709–712.

<sup>21</sup> *European Defence—Industrial and Market Issues: Towards an EU Defence Equipment Policy*, COM (2003) 113 final, Brussels, March 11, 2003; *The Challenges facing the European Defence-Related Industry*, COM (1996) 10 final, Brussels, February 13, 1996, see (1996) 5 P.P.L.R. CS 98–103.

<sup>22</sup> Franco-British Summit, "Joint Declaration on European Defence: Saint-Malo", December 3–4, 1998, [www.weu.int/eng/info/d981204a.htm](http://www.weu.int/eng/info/d981204a.htm). See also, "From St-Malo to Nice, European Defence: core documents", compiled by M. Rutten, Chaillot Paper No.47, Institute of Security Studies of the Western European Union, Paris, 2001, p.8.

<sup>23</sup> Declaration of the European Council on Strengthening the Common European Policy on Security and Defence, European Council Meeting in Cologne, June 3–4 1999, [citation], at point 1, para.2.

<sup>24</sup> European Council, Presidency Conclusions: European Council Meeting in Helsinki, December 10–11, 1999, <http://europa.eu.int/council/off.concl>.

<sup>25</sup> <http://european-convention.eu.int/docs/Treaty/cv00850.en03.pdf>.



Brussels European Council failed to agree on the DCT and it is unlikely it will be passed this year. Nevertheless, it might well be the next fundamental document of the Union, replacing both the TEU and the EC Treaty.

One of three main elements of the EDSP as envisaged by the DCT is an armaments policy. In this context, the DCT proposes the establishment of the European Armaments, Research and Military Capabilities Agency (hereinafter EAA). The Agency is outlined in Arts I-40(3), sub-para.2 and III-212 DCT.

According to the first sentence of Art.I-40(3), sub-para.2 DCT, “the Member States shall undertake progressively to improve their military capabilities.” The second sentence envisages the creation of the EEA. Furthermore, it stipulates its tasks in broad terms. These are the identification of operational requirements and the promotion of measures to satisfy those requirements. This task, which is not repeated in Art.III-212 DCT, complements the first aspect of the EDSP, which is crisis management. The EAA acts as the co-ordinator for procurement, related to crisis management. Moreover, it is to make a contribution to identifying and, where appropriate, implementing any measure needed to strengthen the industrial and technological base with regards to the defence sector. This task is repeated in Art.III-212(1) DCT. Finally, the Agency is to participate in defining a European capabilities and armaments policy and to assist the Council in evaluating the improvement of military capabilities. These tasks are also repeated in Art.III-212(1) DCT. In order to discuss the task of the EAA, Arts I-40(3) sub-para.2 and III-212 DCT have to be read together. According to Art.III-212(1) DCT, the EAA will have the tasks to:

- “(a) contribute to identifying the Member States’ military capability objectives and evaluating observance of the capability commitments given by the Member States;
- (b) promote harmonisation of operational needs and adoption of effective, compatible procurement methods;
- (c) propose multilateral projects to fulfil the objectives in terms of military capabilities, ensure coordination of the programmes implemented by the Member States and management of specific cooperation programmes;
- (d) support defence technology research, and coordinate and plan joint research activities and the study of technical solutions meeting future operational needs;
- (e) contribute to identifying and, if necessary, implementing any useful measure for strengthening the industrial and technological base of the defence sector and for improving the effectiveness of military expenditure.”

All activities are carried out “subject to the authority of the Council of Ministers”. This means that the EAA will be supervised by the main intergovernmental institution of the EU. According to Art.III-212(2) DCT, the EAA shall liaise with the Commission where necessary. This wording indicates only a limited involvement of the main supranational institution. However, this is the arrangement for all aspects of the EDSP. Moreover, it should be emphasised that not the European Council as the highest organ of the EU but only the Council, probably in the composition of the ministers of foreign affairs and/or defence, is the main institution in charge of the EAA. The Council shall also adopt a European decision defining the Agency’s statute, seat and operational rules on the basis of a qualified majority. That decision should take account of the level of effective participation in the activities of the EAA. Specific groups shall be set up within the Agency

bringing together Member States engaged in joint projects. The EAA will be open to all Member States wishing to participate.

The envisaged EEA will not replace but rather complement the defence procurement agencies of the Member States. The activities will be limited and can be divided into four broad groups. First, according to Art.III–212(1)(c) and (d) DCT, the Agency will be in charge of joint research programmes and multilateral projects. This refers to projects where a group of Member States decides to approach the development of a certain piece of equipment on a common basis. In such a case, the common programme would replace individual Member State programmes and the EEA will have the role of a practical co-ordinator and manager. This task is not mentioned in Art.I–40(3), sub-para.2 DCT. It is submitted that this indicates that this rather technical matter was not considered controversial. Moreover, the Member States decide on their participation in an individual research programme or joint project on an ad-hoc basis anyway.

Second, the Agency will be involved in the development of policies. Art.I–40(1), sub-para.2 DCT gives the EAA a broad mandate. It is “to participate in defining a European capabilities and armaments policy”. Art.III–212(1) DCT gives a list of detailed policies the definition of which Agency is to participate. These policies include capability objectives,<sup>26</sup> defence industrial policy,<sup>27</sup> procurement policy,<sup>28</sup> and even policy in relation to operational needs.<sup>29</sup> When Art.III–212(1)(e) DCT speaks of the “industrial and technological base of the defence sector”, it refers to the defence sector of the EU as a whole. As far as its participation in the definition of a European capabilities and armaments policy is concerned, there will be a stronger role for the Council than in the rather technical field of multilateral projects and joint defence research. The Agency will prepare the decisions of the Council. It should be noted that, so far, the Commission has been a major player with regards to European defence industrial policy. Hence, the DCT might cause competition between the two bodies and possibly a loss of competence for the Commission.

Third, according to Art.III–212(1)(b) DCT, the EEA will be involved in the harmonisation of procurement procedures with the objective of making the laws compatible. As outlined above in the context of the new Directive, the procurement of weapons is not automatically or categorically excluded from the application of the EC Treaty and all the EC Public Procurement Directives. By addressing defence procurement rules in the context of the intergovernmental EDSP, the European Convention seems to assume that the procurement of armaments is excluded. However, this might also be an oversight.

Fourth, according to Art.III–212(1)(a) DCT, the Agency will evaluate observance of the capability commitments given by the Member States. This seems to indicate a certain role of an oversight authority for capability commitments. The precise limits of this function, however, are not clearly spelt out.

<sup>26</sup> Article III–212(1)(a) DCT.

<sup>27</sup> Article III–212(1)(e) DCT.

<sup>28</sup> Article III–212(1)(b) DCT.

<sup>29</sup> Article III–212(1)(b) and (d) DCT.

#### 4. OCCAR

The Organisation for Joint-Armaments Co-operation (hereinafter OCCAR<sup>30</sup>) was created on November 12, 1996 by France, Germany, Italy and the United Kingdom. The organisation developed from the earlier Franco-German armaments co-operation structure as a result of the French-German dissatisfaction with the lack of progress to establish a European Armaments Agency within the WEU.<sup>31</sup> The purpose is that of a management organisation for joint programmes involving two or more member nations. The ability of OCCAR to centrally administer contracts was curtailed until it obtained legal status.<sup>32</sup> The OCCAR Convention<sup>33</sup> (hereinafter OCCAR) was signed on September 9, 1998. The ratification process was completed in December 2000 and OCCAR attained legal status on January 28, 2001. According to Art.8 OCCAR, the organisation can cover a large range of activities and may become a fully-fledged armaments agency. OCCAR is situated in Bonn and manages several programmes.<sup>34</sup>

According to Art.8 OCCAR, the organisation shall fulfil the following tasks, “and such other functions as the Member States may assign to it:

- (a) management of current and future co-operative programmes, which may include configuration control and in-service support, as well as research activities;
- (b) management of those national programmes of Member States that are assigned to it;
- (c) preparation of common technical specifications for the development and procurement of jointly defined equipment;
- (d) co-ordination and planning of joint research activities as well as, in co-operation with military staffs, studies of technical solutions to meet future operational requirements;
- (e) co-ordination of national decisions concerning the common industrial base and common technologies;
- (f) co-ordination of both capital investments and the use of test facilities.”

As a basic rule, the “Member States renounce the analytical calculation of industrial juste retour on a programme-by-programme basis, and replace it by the pursuit of an overall multi-programme [and] multi-year balance”.<sup>35</sup> The principle of juste retour, if applied in a strict sense, impedes competition in procurement because the defence industry of the Member State that contributes a certain percentage to a project is entitled to an equal share of the contract. Therefore, this move away from strict juste retour is to be welcomed. However, even the “balance” approach will restrict competition and will not lead to a liberalised defence procurement market in Europe. Moreover, the “balance approach” already implies a certain preference for the industries of the OCCAR Member States.

<sup>30</sup> The abbreviation is based on the French name: Organisme conjointe de coopération en matière d’armement.

<sup>31</sup> “Defence Trade: European Initiatives to Integrate the Defence Market”, United States General Accounting Office, Report to the Secretary of Defence, Washington D.C., October 1997, p.7.

<sup>32</sup> *ibid.*, p.9.

<sup>33</sup> Convention on the Establishment of the Organisation for Joint Armaments Co-operation OCCAR, printed in B. Schmitt, “European armaments cooperation: core documents”, Chaillot Paper No.59, Institute for Security Studies of the European Union, Paris, April 2003, pp.45–59.

<sup>34</sup> The Franco-German “Tiger” attack helicopter, the Franco-Italian Future Surface-to-Air Missile Family, the Belgian-British-French-German-Spanish-Turkish A400M transport aircraft. The latter involves non-OCCAR members.

<sup>35</sup> Article 5 OCCAR Convention.

Article 6 OCCAR reads: “when meeting the requirements of its armed forces, each Member State shall give preference to equipment in whose development it has participated within OCCAR”. This “buy OCCAR” principle represents a violation of Community law. First, it violates the EC Treaty and the existing Directives because the provision does not differentiate between civil goods and hard defence material. However, OCCAR projects will normally concern hard defence material. Second, the provision seems to assume that hard defence material is automatically excluded from the Treaty and the Directive. Whereas this is accurate with regards to the existing Supplies Directive, with regards to the Treaty and the new Directive, Art.296(1)(b) EC is not to be interpreted as an automatic exemption, as was explained above. The exemption has to be invoked, justified, and proven. Therefore, an abstract rule such as Art.6 OCCAR is a violation of the Treaty and the new Directive. Whether a limitation to OCCAR Member States can be justified by Art.296(1)(b) EC needs to be argued for each individual contract and can be subject to review by the European Court of Justice.

The Board of Supervisors is the highest decision-making level within OCCAR, according to Art.10 OCCAR. It shall decide on all matters concerning the implementation of the Convention, including procedures and rules for the awarding of contracts. The board is responsible for decisions regarding the awarding of contracts according to Art.12(f) OCCAR.

The procurement principles are stipulated in Arts 23 to 30 OCCAR. According to Art.23 OCCAR, the detailed rules and procedures on procurement to be applied to contracts awarded by the organisation shall be the subject of a regulation. This regulation is to be adopted by the Board of Supervisors and has to comply with the principles in Arts 24 to 30 OCCAR. Such a regulation is necessary, as the Convention does not contain detailed rules on crucial issues such as the precise procedures, specifications, qualification or remedies. Art.24 OCCAR outlines the principles with regard to procedures and participation. Contracts and sub-contracts shall generally be awarded after competitive tendering. With the unanimous agreement of the participants in the programme, competitive tendering may be extended outside the WEAG States provided the principle of reciprocity applies. Competitive tendering and the award of contracts may be limited to companies and other institutions under the jurisdiction of a Member State participating in the programme concerned, in order to comply with defence and security requirements, or to improve the competitiveness of the European defence technological and industrial base (Art.24 No.4 OCCAR). This implies three scenarios. Normally, competition shall be open to WEAG States. For reasons of defence and security, it can be limited to OCCAR Member States participating in the programme concerned. Subject to reciprocity and the unanimous agreement of the OCCAR Member States participating in the programme, it may be extended beyond the WEAG, for example, including the USA. It is submitted that the possibility to limit procurements according to Art.24 No.4 OCCAR is compliant with the requirements of the Treaty and the current and new Directives. The provision is not an abstract limitation but provides that contracts “may be limited”. Moreover, in compliance with Art.296(1)(b) EC, it accommodates defence and security requirements. The improvement of the European defence technological and industrial base can be interpreted as such a defence and security requirement.

Article 25 OCCAR contains the provisions on contract award criteria. When open to competitive tendering, contracts shall be awarded on the basis of the competitiveness of the offers received rather than on the financial contribution made by the participants, subject to transitional arrangements in the initial phase. This complies with the requirements of Community law as long as the award is made to the most competitive offer and not on the basis of financial contribution. According to Art.27 OCCAR, the criteria for qualification and selection of bidders shall be defined in precise terms before

the bidding process is initiated and processed. According to Art.30 OCCAR, companies not invited to bid and companies whose bid was not successful shall, at their request, be given reasons for their exclusion or for the rejection of their bid. These principles are in compliance with Community law.

## 5. WEAG and WEAO

In the early 1990s, the Western European Armaments Group (hereinafter WEAG)<sup>36</sup> established an Ad Hoc Study Group to review the possibilities of creating a European Armaments Agency (hereinafter WEU-EEA). Due to a lack of the necessary political, legal, and economic conditions, the Study Group did not recommend the implementation of a fully-fledged WEU-EEA at the time.<sup>37</sup> However, the Ad Hoc Study Group continued its work and prepared an organisational framework for such an agency. On this basis, on November 19, 1996, a week after OCCAR was created, in Ostend, the WEAG ministers of defence established the Western European Armaments Organisation (hereinafter WEAO) by signing the WEAO Charter<sup>38</sup> and the European Understanding of Research Organisation, Programmes and Activities (EUROPA). It was intended as a formal subsidiary body of the Western European Union. According to Art.1 of the WEAO Charter, the aim of the organisation is to assist in promoting and enhancing European armaments co-operation, strengthening the European defence technology base and creating a European defence equipment market, in accordance with the policies agreed by the WEAG. The executive body of the WEAO, the Research Cell (abbreviated WRC) is co-located with the WEU Secretariat and the Armaments Secretariat of the WEAG in Brussels. The WRC is considered a possible precursor for the proposed agency, since Art.7 of the 1997 WEAO Charter provides for a broad range of possible activities. These are defence research and technology activities, procurement of defence equipment, studies, management of assets and facilities, and other functions to carry out the aim of the organisation.

The WEAO is an integral part of the WEU and will share that body's fate.<sup>39</sup> The latter features prominently in the Maastricht and Amsterdam versions of the TEU but is deleted from Art.17 of the Nice version. It can be said that the WEU functions are currently in a process of transition to the EU<sup>40</sup> and that this process is already quite advanced. This is also reflected in the ongoing process of transfer of WEU capabilities, institutions, and politico-strategic concepts and other documents to the EU.<sup>41</sup> Therefore, the purpose and remaining status of the "rump WEU" itself is now unclear.<sup>42</sup> Whether the

<sup>36</sup> Austria, Belgium, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Italy, Luxembourg, the Netherlands, Norway, Poland, Portugal, Spain, Sweden, Turkey and the United Kingdom are full members of the WEAG. See: [www.weu.int/weao/site/frameset.htm](http://www.weu.int/weao/site/frameset.htm).

<sup>37</sup> Introduction to WEAO Charter by B. Schmitt, above n.33, at p.11.

<sup>38</sup> Reproduced in Schmitt, *ibid.*, at pp.11–22.

<sup>39</sup> Article 8(a) WEAO Charter.

<sup>40</sup> The WEU itself uses the term "transition", see the Marseilles Declaration, WEU Ministerial Council, Marseilles, November 13, 2000, Para.5: "They [the ministers] also agreed to suspend application of the routine consultation mechanisms in force between the WEU and the EU, without prejudice to the cooperation required within the framework of the transition process." During the same meeting it was decided that the dialogue and co-operation, which the WEU at 28 and 21 had developed with the associate members, associate partners and observers, would cease. See para.4: "[...] these responsibilities would be taken up within the existing framework of political dialogue between the EU and the countries concerned." Rutten, "From Saint Malo to Nice", above n.22, p.147, at p.148.

<sup>41</sup> See, for example, Section V of the Presidency Report on the European Security and Defence Policy, Annex VI to the Presidency Conclusions of the European Council in Nice is entitled "Inclusion in the EU of the Appropriate Functions of the WEU", see Rutten, *From Saint Malo to Nice, ibid.*, p.168, at p.173.

<sup>42</sup> P. P. Craig and G. de Búrca, *EU Law* (3rd. ed., OUP, Oxford, 2003), p.45.

organisation will become completely redundant depends on whether the EU will take over all the WEU's tasks. "Support for WEAG/WEAO" was listed as one of the residual functions the WEU still has after Nice.<sup>43</sup> As discussed above, the EU-EEA proposed in the DCT has a fairly comprehensive mandate. After the eventual entering into force of the Constitutional Treaty and the establishment of an EEA, the continued co-existence of WEAO and WEAG could lead to a wasteful duplication of efforts. Therefore, it seems likely that the functions of WEAG and WEAO will be transferred to the EEA once the latter is operational.

## 6. Conclusions

European defence procurement is moving forward, but slowly. The EU, WEU, and OCCAR made and continue to make efforts towards the establishment of a European Armaments Agency as a core contribution to a European defence equipment market. However, whereas the benefits of a European Armaments Agency are widely appreciated, the benefit of three or more such agencies is doubtful. A fragmentation of efforts reveals substantial differences between the countries involved and ultimately perpetuates the fragmentation of the market. This deprives the European defence industries of economies of scale thereby undermining their competitiveness. Moreover, fragmentation leads to duplication, a remarkable luxury in times of decreasing defence budgets and diminished tax income. The emerging Constitutional Treaty might finally lead to a single EEA and ultimately a liberalised European defence equipment market.

<sup>43</sup> Reply of the WEU Council to a written question of WEU Parliamentary Assembly member Mr Martinez-Casan on the results of the (classified) WEU Council Meeting in Brussels, June 28, 2001, cited by Rutten, "From Nice to Laeken", above n.22, p.69.

## News and Analysis

### *European Court of Justice/Court of First Instance*

## Inadmissibility of a Challenge to the Commission's Decision to Close its File on Thessaloniki Metro: Case T-202/02 *Makedoniko Metro and Michaniki v Commission*<sup>1</sup>

Adrian Brown

*Herbert Smith, Brussels*

### 1. Facts

This case arose from the award procedure carried out by the Greek State for the construction, financing and operation of an underground metro system in Greece's second city, Thessaloniki. A consortium called Makedoniko Metro ("MM"), including the company Michaniki, had, in 1994, been provisionally chosen as preferred bidder. MM was, however, subsequently rejected in 1996 because a major change in its membership occurred after submission of tenders. The contract was awarded instead to another consortium, Thessaloniki Metro. MM brought unsuccessful actions before the Greek Council of State, the Athens Administrative Court and ultimately the Athens Appeal Court. During those proceedings, the Athens Appeal Court referred a question to the European Court of Justice, asking whether Works Directive 93/37/EC precludes a national rule prohibiting post-selection changes in the composition of a bidding consortium. The Court replied, in Case C-57/01, that such a national rule was permitted, as noted in an earlier issue of the *Public Procurement Law Review*.<sup>2</sup>

In January 1997, MM also submitted a complaint to the European Commission. Upon investigating the matter, the Commission found that the tender documents were unclear and capable of different interpretations. Commissioner Monti called on the Greek authorities to re-draft the tender documents and to take steps to avoid any future breaches. However, the Commission considered that it could not prove any clear infringement. In August 1998, the Commission therefore decided to close

<sup>1</sup> Order dated January 14, 2004, unreported, or (at time of writing) available in English, but available in French and Greek on the Court's website: [www.curia.eu.int](http://www.curia.eu.int).

<sup>2</sup> Judgment dated January 23, 2003; noted by the current author in (2003) P.P.L.R. 2 at NA56.

its file. MM then sent further letters alleging various breaches. The Commission replied in December 1998 that MM had not provided any new elements to justify re-opening the file.

MM then complained to the European Ombudsman. The Ombudsman partially upheld that complaint, finding in its decision of January 31, 2001 that the Commission had been guilty of maladministration in failing to explain sufficiently its decision to close the file or to give MM an adequate opportunity to explain its case before closure of the file.<sup>3</sup>

Finally, in July 2002, MM lodged the current action at the Court of First Instance, seeking compensation from the Commission. According to the Court's order (para.30), MM asked the Court to order the Commission to pay damages comprising:

- €23,578,050, €224,654 and €60 million payable to Michaniki (basis not specified);
- €15 million, payable to the president of Michaniki as compensation for damage to his reputation;
- €1,025,839,589 payable to Michaniki for loss of profit; and
- €110,754,352 to Makedoniko Metro, of which 20 per cent would go to its member Adtranz and 0.35 per cent to Transurb Consult.

MM also asked the Court to order the Commission to send a note to all of its services in order to re-establish the good reputation of Michaniki and its president. It requested various other organisational measures, such as the disclosure of certain Commission documents and the calling of the European Ombudsman and others as witnesses.

## 2. The Court's order

The Court's order deals only with the question of admissibility of MM's action. The Commission argued that MM's action was inadmissible. It submitted that case law establishes that a Commission decision to refrain from taking action against a Member State under Art.226 EC cannot constitute an illegal action and thus cannot give rise to non-contractual liability for damages on the part of the Community. Furthermore, the Commission's decision to close its file did not amount to the approval or imposition of the Greek State's decision to exclude MM.

MM counter-argued that the Commission failed in its duty of good administration to consider MM's complaint, to keep MM informed and to give a reasoned decision, as found by the European Ombudsman. It therefore exceeded the limits of its discretionary powers under Art.226 EC. MM also alleged that the Commission had failed to take necessary action against Greece under Art.3 of the Remedies Directive 89/665. MM maintained that its action fulfilled the conditions necessary for a damages claim under Art.288 EC.

The Court sided with the Commission. It agreed that, according to case law, a Commission decision not to take action under Art.226 EC cannot amount to an unlawful act and hence cannot give rise to non-contractual liability on the part of the Community. It is only the conduct of the Member State concerned (here Greece) that may be a source of prejudice. The Court listed five cases in support, including C-72/90 *Asia Motor France/Commission* and T-209/00 *Lambert Mediateur*. Consequently, an action for damages based on the Commission's failure to bring an action under Art.226 EC is inadmissible.

<sup>3</sup> Decision available on the website: [www.euro.ombudsman.eu.int/decision/en/980995.htm](http://www.euro.ombudsman.eu.int/decision/en/980995.htm).



The Court added that the Commission is not obliged to start an action under Art.226 EC but enjoys a discretionary margin of appreciation. It follows that a complainant does not have the right to bring an action in the Court regarding a failure to take such an action and does not benefit from procedural rights comparable to those of a complainant under Reg.17, which governs the Commission's enforcement of the Treaty's competition provisions. Furthermore, the Commission's decision to close its file did not undermine MM's action against the Greek authorities in the Greek courts. While a national judge may take into account such a Commission decision, it is not bound to follow suit by also refraining from taking any action.

The Court also dismissed as inadmissible MM's claim based on the Commission's failure to invoke the procedure laid down in Art.3 of Directive 89/665. The Court pointed out that this procedure is also discretionary and that a decision not to use it does not constitute illegality and may not give rise to non-contractual liability. Even if the Commission is invited to make use of the said procedure, it retains its discretion to examine the complaint under Art.226 EC instead.

Finally, the Court declared inadmissible MM's request for an injunction obliging the Commission to send a note to its services in order to repair the reputation of Michaniki and its president. The Court pointed out that it lacks the power to issue injunctions against a Community institution.

### 3. Comments

This case comprised an audacious (some would say desperate) attempt by MM, as a losing tenderer and rejected complainant, to recover substantial financial damages from the Commission, in respect of the latter's failure to bring an action against the Greek authorities condemning the conduct of the national award procedure in question. The sums claimed by MM were massive, totalling over €1.2 billion and constituting one of the largest damages actions ever lodged before the European Courts.<sup>4</sup>

MM's action was, however, always very likely to be rejected as inadmissible. The Court's case law has consistently held that the Commission's power to commence infringement proceedings under Art.226 EC is discretionary and that a decision to refrain from bringing such proceedings cannot expose the Commission to a claim for damages on the basis of non-contractual liability. The same is also true of the Commission's parallel power to intervene under Art.3 of the Remedies Directive 89/665. Instead, any action for compensation has to be lodged in the appropriate national court, against the national institution that actually committed the alleged infringement of EU law. It made no material difference in the current case that the European Ombudsman had taken a decision criticising the way in which the Commission conducted the administrative procedure leading to its decision not to intervene.

It is interesting to note that MM chose not to seek to bring an action against the Commission under Art.232 EC for failure to act. If it had done so, earlier case law indicates that such an action would also have failed, on the basis that the Commission's powers under Art.226 are discretionary and it is not under an obligation to bring such an action.<sup>5</sup>

<sup>4</sup> The total amount claimed by MM is, for example, considerably larger than the amount of £518 million (around €760 million) that MyTravel (formerly Airtours) is reported to be claiming as compensation pursuant to the Commission's controversial decision to prohibit the proposed merger between Airtours and First Choice, which the Court of First Instance annulled in 2001.

<sup>5</sup> Case 247/87 *Star Fruit Company SA v Commission* [1989] E.C.R. 291. That judgment also suggests that MM may have had difficulty satisfying the further requirement that the act that the Commission failed to take was of direct and individual concern to MM. Article 232 also imposes a further hurdle: an action would only be admissible if the Commission were first called upon to "define its position" and it then failed to do so within two months. For all these reasons, actions under Art.232 have been very rare in practice.

The ruling therefore serves to highlight some of the main drawbacks of bringing a procurement complaint before the Commission.<sup>6</sup> In particular, the Commission's response to a complaint may be slow (or even non-existent) and there is no guarantee that it will ultimately exercise its discretion to intervene. Even if it does so, that action will be against the Member State government, rather than directly against the awarding authority, and it will not offer any direct financial remedy for the complainant. Furthermore, the current case confirms that the complainant will have no effective means of challenging, or seeking compensation for, any Commission decision not to intervene.

This case is therefore likely to encourage the trend towards decentralised enforcement of the EU procurement rules through litigation in the national courts, rather than via complaints to the Commission. This trend, which is also being witnessed in the field of EU competition law, makes sense and accords with the general EU principle of "subsidiarity", given the limited resources and powers of the Commission and given that national courts are usually better able to carry out detailed assessments of fact and law in relation to national award procedures. Complaints to the Commission are likely to be used mainly as a supplement to an action in the national court (as in the current case) in order to exert additional "political" pressure on the national authorities, or where the aggrieved party is particularly keen to minimise costs or to preserve anonymity.

<sup>6</sup> For a comprehensive critique of the Commission's enforcement powers, see Amandine Delaux, "The Role of the Commission in Enforcing EC Public Procurement Rules" (2004) 13 P.P.L.R. 129.

# The EC Judgment in AOK: Can a Major Public Sector Purchaser Control the Prices it Pays or is it Subject to the Competition Act?

## Cases C-264/01, C-306/01, C-354/01 and C-355/01: *AOK Bundesverband v Ichthyol (AOK)*, ECJ, March 16, 2004

Jennifer Skilbeck

### 1. Introduction

Pressure on the public sector to increase the efficiency of its purchasing has led to some public sector purchasers adopting practices which may be unfair and anti-competitive. The OFT is currently investigating the purchasing practices of public bodies, and a judgment of the European Court of Justice in *AOK* (March 16, 2004) represents a further development in the attempts of suppliers to hold back the increasingly aggressive approach of parts of the public sector.

What terms in a public supply or services contract might conceivably be anti-competitive? A sole purchaser may impose an unreasonably low purchase price; central purchasing may, by selecting one supplier, eliminate efficient suppliers from the market altogether; framework (or call-off) contracts may result in “bulk” prices being tendered, with no guarantee of any or sufficient orders being forthcoming; other terms may require normally confidential commercial information, such as prices charged to other customers, being revealed. All these potentially anti-competitive practices may thrive in markets in which the supplier is dependent or substantially dependent on one buyer, and thus in a weak negotiating position.

### 2. The facts

The facts of *AOK* represent a prime example of the problem. The German health insurance sector is principally supplied by non-profit making companies which fulfil certain statutory obligations as to the levels of care offered. A number of changes were introduced which, according to the judgment, were intended to reduce the costs of the system. An important aspect of the arrangements concerned the statutory scheme under which the insurance funds together set the maximum prices that they will pay for categories of pharmaceutical products (according to certain principles). If the funds cannot agree, the minister sets the rate. A number of pharmaceutical companies challenged the price setting procedure under Art.81(1) as an agreement between undertakings (or an association of undertakings).

An important issue was bound to be whether the insurance funds were “undertakings” for the purpose of Art.81. The funds incorporate a sophisticated system of “solidarity” (insurance cover operated on “social” rather than an “actuarial” basis), which simultaneously delivers an income-related basis of contributions, the subsidisation of funds accepting the higher risks by those accepting

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lower risks, and competition both on premiums and in respect of the provision of services that are not compulsory.

### 3. The judgment

The pharmaceutical companies had, according to the evidence of the judgment, relied on the competition between funds in terms of premiums and non-statutory benefits as establishing that the funds are “undertakings” for the purpose of Art.81. However, the Court held that the insurance companies are not “undertakings”: they are established on the principle of solidarity, and do not compete in the benefits they are required to provide. The element of competition was introduced by the German Government to improve management and was said by the Court not to affect the social nature of the funds’ activities. In respect of those activities which are not subject to the principle of “solidarity” and which are outside the German social security system, the companies may, however, be “undertakings”.

The question then arose as to whether the provisions, under which the maximum prices were set, were linked to the funds’ social functions. The ECJ concluded that they were. Setting maxima is a task for “the management of the German social security system” and not part of an economic activity.

### 4. Comment

The Court’s finding is superficially simple and attractive. Where a fund pursues a social objective based on “solidarity” (non-actuarial principles), it is not an “undertaking” and not, it seems, subject to the competition provisions of the Treaty.

However, there are a number of possible implied qualifications in the judgment. Would the funds have been subject to Art.81 if they had fixed the maximum prices in the absence of any laws providing for them to be so fixed? The answer is probably not, in so far as they related to the supply of services within the social function. Could they have used those prices in respect of any supply of services outside those compulsory functions? The answer here is probably not. What about the implications for Art.81 of the existence of any competition between private medicine and the social funds? None was mentioned—the existence of any such competition could not have affected the “social” nature of the funds themselves, yet the Court was careful to base its conclusions on the nature of the competition *between* funds which did not affect the fixed and social nature of their obligations.

What is missing altogether from the judgment is any mention of the points in issue in the earlier cases of *BetterCare*<sup>1</sup> and *Fenin*.<sup>2</sup> *BetterCare*, established for the purposes of UK law (and subject to the subsequent findings of the European Court) that a public body could be an “undertaking” solely on account of its purchasing function. After all, an economic activity depends equally on buyers and sellers and there is no economic reason why the concept of an “undertaking” should apply only to one side of the equation. Hence, in *BetterCare*, the CAT held that a hospital Trust was an “undertaking” in the purchase of long term care for the elderly (although the prices it fixed and that were challenged

<sup>1</sup> Competition Commission Appeal Tribunal, August 1, 2002. See further, Skilbeck, “The Circumstances in which a Public Body may be Regarded as an ‘Undertaking’ and thus Subject to the Competition Act 1998 Solely Because of its Function as a Purchaser of Particular Goods or Services” (2003) 12 P.P.L.R. NA71; Skilbeck, “Just When is a Public Body an ‘Undertaking’? *Fenin and BetterCare* Compared” (2003) 12 P.P.L.R. NA75.

<sup>2</sup> Case T-319/99, [2003] 5 C.M.L.R. 1, Judge Vesterhof (President), CFI. See Skilbeck, “Just When is a Public Body an ‘Undertaking’? *Fenin and BetterCare* Compared” (2003) 12 P.P.L.R. NA75.

might fall outside the provisions of the Competition Act if fixed by an order of legal effect). This point was also raised in *Fenin* in respect of the Spanish health care system. Because its purchases were made exclusively for the fulfilment of its social functions, it was not an undertaking. That decision is the subject of an appeal to the ECJ.

The Advocate General's opinion in *AOK* is interesting and substantially different from the judgment of the Court. Advocate General Jacob concluded that the funds were "undertakings" because of the competition between them; the price fixing mechanism amounted essentially to a purchasing "cartel", expressly identified within the mischief of Art.81(1), and which ought to be subject to the same strict control as supply cartels. Nevertheless since it was sanctioned by law it was for the national court to decide whether it was exempt from the competition provisions under Art.86(2). The Advocate General's opinion has been rejected, but nevertheless summarises, in simple form, the continuing problems that will be faced by suppliers to dominant public sector purchasers. This approach to public procurement, while bringing short-term savings, may ultimately cause the disappearance of innovative and competitive suppliers in a number of areas of importance to public welfare.

# Challenging Discriminatory Technical Specifications Under The Remedies Directives: The Grossman Case

Case C–230/02 *Grossmann Air Service, Bedarfsflugunternehmen GmbH & Co. KG v Republic of Austria*, ECJ judgment of October 16, 2003, nyr<sup>1</sup>

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## 1. Introduction

This present case concerned a request by the Bundesvergabeamt (Federal Public Procurement Agency—“BVA”) to the European Court of Justice for a preliminary ruling under Art.234 EC on the interpretation of Art.1(3) of Directive 89/665. The BVA referred two questions to the Court which were raised in proceedings between *Grossmann Air Service, Bedarfsflugunternehmen GmbH & Co. KG* and *Republic of Austria* concerning a public services contract.

## 2. Facts of the Main Proceedings

In January 1998, the Federal Ministry for Finances (the “Ministry”) invited tenders for the provision for the Austrian Federal Government and its delegations of non-scheduled passenger transport services by air in executive jets and aircraft. Grossmann, the applicant in the main proceedings, participated in the award procedure for that contract by submitting a tender.

In April 1998, the Ministry decided to annul the first invitation to tender, because it had received only one compliant offer for that tender. In July 1998, the Ministry then issued another invitation to tender for these transport services. Grossmann obtained the documents for that invitation to tender, but did not submit an offer. By letter of October 8, 1998, the Austrian Government notified Grossmann of its intention to award the contract to Lauda Air Luftfahrt AG (“Lauda Air”). Grossmann received that letter on the following day. The contract with Lauda Air was concluded on October 29, 1998.

By application dated October 19, 1998, posted on October 23 and received on October 27, 1998, Grossmann applied to the BVA to have the contracting authority’s decision to award the contract to

<sup>1</sup> The judgment (rapporteur R. Schintgen) and the Opinion of AG Geelhoed are available at the Court’s website at <http://curia.eu.int> in English.

Lauda Air set aside. In support of its application Grossmann claimed essentially that the invitation to tender had been tailored from the beginning to one tenderer, namely Lauda Air. The BVA dismissed Grossmann's application on two grounds. First, Grossmann failed to assert its legal interest in obtaining the contract, because it had not submitted a tender in the second award procedure for the contract at issue. Secondly, after the award of the contract, the BVA no longer has competence to set aside unlawful decisions of the contracting authority; it can only determine, on grounds of an infringement of the applicable federal law and any regulations issued thereunder, whether the contract has not been awarded to the best tenderer.

Grossmann thereupon appealed to the Constitutional Court of Austria to have the BVA's decision set aside. The Court annulled that decision and referred the case back to the BVA for breach of the constitutionally guaranteed right to proceedings before the ordinary courts, on the ground that the BVA had wrongly failed to refer a question to the Court of Justice for a preliminary ruling on the compatibility of the national rules with Community law.

The BVA thereupon decided to stay proceedings and refer three questions to the Court for a preliminary ruling, which can be summarised as follows:

1. Is Art.1(3) of Directive 89/665 to be interpreted to mean that the review procedure must be available to any undertaking which has submitted a bid, or applied to participate, in a public procurement procedure? In the event that the answer to Question 1 is in the negative:
2. Is the abovementioned provision to be understood to mean that an undertaking only has or has had an interest in a particular public contract if—in addition to its participating in the public procurement procedure—it takes all steps available to it under national law to prevent the contract from being awarded to another bidder?
3. Is Art.1(3) of Directive 89/665, in conjunction with Art.2(1) thereof, to be interpreted to mean that an undertaking must be afforded the opportunity in law to seek review of an award procedure regarded by it as unlawful or discriminatory even where it is not capable of performing the totality of the services for which bids were invited and, for that reason, did not submit a bid in that award procedure?

## 3. Judgment

### 3.1. First and Third Questions

The Court examined the first and third questions together. It reformulated them and essentially considered whether Arts 1(3) and 2(1)(b) of Directive 89/665 must be interpreted to mean that a person can be deemed, after the contract award, to have lost its interest in obtaining a particular public contract and thus its right of access to the review procedures provided for by the Directive, where it neither participated in the contract award procedure at issue nor appealed against the invitation to tender before the contract was awarded.

The Court considered these two grounds separately. Regarding the failure to participate in the contract award procedure, the Court first recalled that, in accordance with Art.1(3) of Directive 89/665, the Member States are required to ensure that the review procedures provided for are available at least to any person having or having had an interest in obtaining a particular public contract and who

has been or risks being harmed by an alleged infringement of the Community law on public procurement or national rules transposing that law. On this basis the Court concluded that participation in a contract award procedure may, in principle, constitute a valid condition under the Directive, which must be fulfilled before the person concerned can show an interest in obtaining the contract at issue, or that it risks suffering harm as a result of the allegedly unlawful nature of the decision to award that contract. This is because if it has not submitted a tender, it will be difficult for such a person to show that it has an interest in challenging that decision or that it has been harmed or risks being harmed as a result of that award decision.

The Court then went on, however, to point out that where an undertaking has not submitted a tender because of allegedly discriminatory specifications in the tender or contract documents, which prevent it from being in a position to provide all the services requested, it would be entitled to seek review of those specifications directly, even before the procedure for awarding the contract concerned is terminated. The Court based its view on two grounds. On the one hand, it would be too much to require an undertaking allegedly harmed by discriminatory clauses in the tender or contract documents to participate in the award procedure for the contract at issue in order to avail itself of the review procedures provided for by Directive 89/665 against such specifications, where its chances of being awarded the contract are non-existent by reason of the existence of those specifications. On the other hand, it is clear from the wording of Art.2(1)(b) of Directive 89/665 that the review procedures must, in particular, set aside unlawful decisions of the contracting authority, including the removal of discriminatory technical, economic or financial specifications. It must, therefore, be possible for an undertaking to seek review of such discriminatory specifications directly, without waiting for the contract award procedure to be terminated.

Regarding the absence of proceedings against the invitation to tender, the Court recalled that Directive 89/665 is intended to strengthen the existing mechanisms, both at national and Community level, to ensure the effective application of Community directives relating to public procurement, in particular at a stage when infringements can still be remedied. These objectives are impaired, according to the Court, where a person does not seek review against discriminatory technical specifications which—in its view—effectively disqualify it from participating in the award procedure for the contract at issue, but awaits notification of the decision awarding the contract and then challenges it before the body responsible, on the ground specifically that those specifications are discriminatory. Such conduct impairs the effective implementation of the Community directives on the award of public contracts, since it may delay, without any objective reason, the commencement of the review procedures which Member States were required to institute by Directive 89/665. In those circumstances, a refusal by the review body to acknowledge the interest in obtaining the contract in question and, therefore, the right of access to the review procedures provided for by Directive 89/665, does not impair the effectiveness of that directive.

Based on these considerations, the Court answered the first and third question as follows:

“Articles 1(3) and 2(1)(b) of Directive 89/665 must be interpreted as not precluding a person from being regarded, once a public contract has been awarded, as having lost its right of access to the review procedures provided for by the Directive, if it did not participate in the award procedure for that contract on the ground that it was not in a position to supply all the services for which bids were invited, because there were allegedly discriminatory specifications in the documents relating to the invitation to tender, but it did not seek review of those specifications before the contract was awarded.”



### 3.2. Second Question

By this question, the BVA essentially sought to know whether a person who has participated in a contract award procedure may be regarded as having lost its interest in obtaining the contract where, before seeking the review provided for by the Directive, it failed to refer the case to a conciliation committee such as the Federal Public Procurement Conciliation Committee (“B-VKK”).

The Court dealt with this question very briefly. It recalled the *Fritsch* case,<sup>2</sup> where it had already held that subjecting the access to the review procedures to prior referral to a conciliation committee such as the B-VKK would be contrary to the objectives of speed and effectiveness of that directive.

On the basis of this precedent, the Court then answered the second question to the effect that:

“Article 1(3) of Directive 89/665 must be interpreted as precluding a person, who has participated in a contract award procedure, from being regarded as having lost its interest in obtaining the contract on the ground that, before seeking the review provided for by the Directive, it failed to refer the case to a conciliation committee such as the B-VKK”.

## 4. Comments

The Court’s answer to the first two questions comes to no surprise as both questions have been addressed by the Court in recent case law.

The first question of the BVA essentially seeks to ascertain whether a tenderer may already avail itself of the remedies provided for in the Remedies Directive in order to prevent the contract being awarded to a third party, where it has merely expressed its interest in obtaining the particular public contract by participating in the award procedure. The Court had answered this question in the negative in the *Hackermüller* case.<sup>3</sup> The Court essentially held that for a bidder to have access to the remedies provided for by the Remedies Directive, a Member State may lay down requirements additional to the mere participation of the bidder in the tendering procedure. In particular, the bidder concerned may be requested to prove that it has been or risks being harmed by the infringement it alleges.

The second question of the BVA essentially seeks to ascertain whether a tenderer may avail itself of the remedies provided for in the Remedies Directive, where it has not exhausted all remedies available to it under national law. The Court had answered this question affirmatively in the *Fritsch* case.<sup>4</sup> The Court held that a Member State cannot make a tenderer’s interest in obtaining a specific contract—and thus its right to institute the review procedures established by that directive—subject to the condition that it has beforehand applied to a conciliation commission, because such a condition is contrary to the directive’s objective of speed and effectiveness. The Court acknowledged that the Remedies Directive expressly allows Member States to determine the detailed rules according to which they must make the review procedures available to aggrieved tenderers. However, that provision does not, according to the Court, allow the review bodies to give the term “interest in obtaining a public contract”, an interpretation which may limit the effectiveness of that directive.

<sup>2</sup> Case C-410/01 *Fritsch, Chiari & Partner, Ziviltechniker GmbH v Autobahnen- und Schnellstraßen Finanzierungs-AG (ASFINAG)* nyr; noted by the current author in (2004) 13 P.P.L.R. at NA14.

<sup>3</sup> Case C-249/01 *Werner Hackermüller v Bundesimmobiliengesellschaft MbH (Big) und Wiener Entwicklungsgesellschaft MbH Für Den Donaauraum Ag (Wed)*; noted by the current author in (2004) 13 P.P.L.R. at NA36.

<sup>4</sup> See n.2 above.

The rule that seems to follow from the Court's reply to the first two questions and the previous case law is that participation in the award procedure is in principle a precondition for demonstrating an interest in obtaining a contract and access to the remedies provided for by the Remedies Directive. The Court seems to be of the view that it is difficult for a person who has not participated in the award procedure to maintain that it has an interest in challenging an allegedly unlawful decision around the award of a public award.

In light of the Court's considerations and reply to the third question of the BVA, however, this rule does not apply, where it makes no sense for potential candidates to tender for a contract. This is particularly the case where the specifications for the particular contract are laid down in such a way that potential candidates are unable to satisfy them from the outset. In this situation, potential candidates to tender for a contract must be given the opportunity to apply for review of discriminatory specifications without participating in the tendering procedure.

It is important to note, however, that this new direct avenue to challenge discriminatory technical specifications is subject to the condition that potential tenderers use the opportunity to challenge such specifications before the review bodies at the earliest possible opportunity. Aggrieved tenderers may not put back the challenging of the invitation to tender before a review body until it is apparent that they did not win the contract. Where potential tenderers do so, as *Grossmann* did in the present case, they may be considered as having lost their interest in the particular contract and thus as having forfeited their right to challenge the invitation to tender by means of the remedies provided in the Remedies Directives.

# Iraq Reconstruction: US Government Procurement Practices in a Coalition Environment<sup>★</sup>

Robert Nichols<sup>1</sup>

## 1. Introduction

The massive rebuilding efforts in Iraq are in full swing. Iraq's needs have been identified, tens of billions of dollars have been appropriated and donated to support this effort, and the contracting activities are established and operating. The opportunities for private-sector participation are widespread.<sup>2</sup> As the Coalition Provisional Authority (CPA) recently declared—

“The state of the Iraqi infrastructure is a reflection of years of neglect by a totalitarian regime that focused on only a few. Under a free Iraq, the reconstruction process will involve the input of the Iraqi people and their governmental ministries in the development of projects and products that will reinvigorate the country for self-sufficiency in the future. . . . The urgency of this requirement will require an innovative acquisition strategy . . .”<sup>3</sup>

The CPA's newly commissioned Iraq Infrastructure Reconstruction Program Management Office (PMO) is leading the reconstruction effort. Working with public and private experts in construction contracting, the PMO has sought to develop “the most efficient and effective method of accomplishing a program of this magnitude and at the same time maximising realistic competition.”<sup>4</sup> To implement this objective, solicitations were recently issued for 10 major Iraq reconstruction contracts and seven program management service contracts, with a total value of approximately \$5 billion and substantial subcontracting opportunities.

The reconstruction contracts funded by US appropriations are based largely on US federal procurement principles. Any contractor interested in participating—whether from the United States or another Coalition-partner country—must understand not only the fundamental procurement standards, but also the unusual aspects of the acquisition approach taken in the wartime environment. This article describes this contracting landscape.

\* This article is derived from a Feature Comment, “Iraq Reconstruction—Significant Contracting and Legal Issues”, published January 28, 2004 in *The Government Contractor*, 46 GC 39. *The Government Contractor*, a US-based newsletter covering procurement by the US Government, is published weekly by West, a Thomson business.

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<sup>2</sup> See “Business Guide for Iraq”, US Department of Commerce, October 8, 2003.

<sup>3</sup> “Statement of Objectives for Coalition Provisional Authority Program Management Office and Sector Program Management Offices”, January 6, 2004, available at: [www.rebuilding-iraq.net/pls/portal/docs/PAGE/IPMO/ABOUT\\_PMO/ACQUISITION/PROJECTS\\_RFP/STATEMENT\\_OF\\_OBJECTIVES.PDF](http://www.rebuilding-iraq.net/pls/portal/docs/PAGE/IPMO/ABOUT_PMO/ACQUISITION/PROJECTS_RFP/STATEMENT_OF_OBJECTIVES.PDF).

<sup>4</sup> “Statement of Objectives”, above, p.1.

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## 2. Iraq's needs and private sector opportunities

In October 2003, the United Nations and the World Bank issued a Joint Iraq Needs Assessment on immediate (2004) and near-term (2005–2007) reconstruction requirements in Iraq.<sup>5</sup> Following is a broad sampling of Iraq's immediate needs, as well as opportunities for businesses to participate in the process:

### 2.1 Infrastructure and transportation

Decades of conflict and neglect have seriously degraded Iraq's infrastructure. There are immediate needs for rebuilding the water supply system, sanitation, solid waste, highways, roads, bridges, railways, airports and civil aviation, ports and inland waterways, public transport, and freight and commercial transport.

### 2.2 Communications

Iraq's communication sector is significantly underdeveloped in all areas. Contracts are expected for the expansion of the switching and local access networks, the postal system, and hardware and software to operate those systems.

### 2.3 Education

One quarter of Iraqi children do not attend primary or secondary schools, due primarily to poverty, poor quality of instruction, and past politicization of the curriculum. Contracts should be awarded to provide basic training for teachers, needed materials and equipment, physical rehabilitation of schools, and development of new curriculum and educational priorities.

### 2.4 Health

The previous regime reduced health care spending by 90 per cent, resulting in health levels comparable to the least-developed countries. Contracts are expected for the implementation of public health programs, rehabilitation of essential infrastructure and health services, development of a national health plan, and medical equipment and supplies.

### 2.5 Electricity

Most generation stations are only partially operable because of the absence of maintenance and spare parts. Recommendations for rehabilitation works and new programs are now being sought and considered.

<sup>5</sup> The Needs Assessment was developed jointly by the UN Development Group and the World Bank Group, in accordance with the Provisions of para.8 of UN Security Council Resolution 1483. Contributors to the Assessment also included experts from the European Commission, Australia, Japan, member countries of the European Union, the International Monetary Fund, and the Coalition Provisional Authority in Iraq. See United Nations/World Bank, "Joint Iraq Needs Assessment" (2003), available at: [http://lnweb18.worldbank.org/mna/mena.nsf/Attachments/Iraq+Joint+Needs+Assessment/\\$File/Joint+Needs+Assessment.pdf](http://lnweb18.worldbank.org/mna/mena.nsf/Attachments/Iraq+Joint+Needs+Assessment/$File/Joint+Needs+Assessment.pdf).

## 2.6 Houses

Houses are of low quality due to poor construction, overcrowding, and lack of maintenance. A wide range of contracts should be forthcoming for a new system of land management, training for labourers and management, the building of additional units, and a 15-year upgrading program.

## 2.7 Agriculture, water resources and food security

These sectors are under performing due to past policies that maintained artificially low food prices, production controls, and marketing restrictions. Contracts can be expected for rehabilitation and expansion of critical infrastructure, assessment of water resources and needs, and development of food security controls.

## 2.8 Finance and private sector

Iraq's financial system is dysfunctional, with little financial intermediation, ineffective institutions, and a poorly organised regulatory framework. Contracts will be awarded for the rewriting of laws in this area, modernisation of offices and technology, and reform of accounting and banking standards to ensure congruence with internationally-applicable standards.

These examples of the broad range of identified needs suggest that the opportunities in Iraq are similar to, but also go beyond, the traditional roles of government contractors.<sup>6</sup> The UN/World Bank Assessment estimates that these immediate and near-term needs will cost \$36 billion through 2007. This is the most ambitious program of nation building since the Marshall Plan in 1947.<sup>7</sup>

## 3. Framework of the Coalition and US contracting activities

The CPA—a coalition of Nations—is the temporary governing body designated by the United Nations as the lawful government of Iraq.<sup>8</sup> From its inception, the CPA was designed to function in that role until Iraq is sufficiently stable, politically and socially, to assume its sovereignty.<sup>9</sup> In addition to protecting Iraqi territorial integrity and working to provide security to the Iraqi people, the CPA has committed itself to rebuilding all aspects of Iraqi infrastructure so that, upon turnover, the democratically-elected Iraqi Government can assume authority over a country ready, both internally and externally, to function economically, to provide basic services to its citizens, to provide for its own defence, and to play a responsible role in the community of nations.

<sup>6</sup> Indeed, BearingPoint, Inc., a Virginia based consulting company, won a \$9 million contract to support integrated and sustainable economic reform in Iraq. BearingPoint's work will involve the examination of Iraqi Government policies, laws, regulations, and institutions to advise on ways to create a competitive private sector.

<sup>7</sup> See, RAND, "America's Role in Nation-Building: From Germany To Iraq" (2003), at xxvii.

<sup>8</sup> See, "CPA Overview", available at: [www.cpa-iraq.org/bremerbio.html](http://www.cpa-iraq.org/bremerbio.html).

<sup>9</sup> That date has now been set for June 30, 2004, by the CPA and the Iraqi Governing Council. See, "The November 15 Agreement: Timeline To a Sovereign, Democratic and Secure Iraq", available at: [www.iraqcoalition.org/government/AgreementNov15.pdf](http://www.iraqcoalition.org/government/AgreementNov15.pdf). On that date, the new transitional administration will be recognised by the Coalition, and will assume full sovereign powers for governing Iraq.

Iraq reconstruction contracts are being awarded primarily by two groups: the CPA and the US Government.<sup>10</sup> The CPA awards contracts funded by the Development Fund for Iraq,<sup>11</sup> comprised of proceeds of oil and gas sales, frozen Iraqi assets, the UN oil-for-food program, and contributions from the United Kingdom, Japan, the World Bank, and others. US Government agencies award contracts funded by US appropriations.

The CPA's PMO was commissioned to oversee and direct the contracting process. With offices in Baghdad and Washington DC, the PMO provides oversight, management, and execution of the infrastructure reconstruction efforts in Iraq. In broadest terms, the PMO is responsible for all of the program's activities, projects, assets, construction, and financial management. The PMO's "strategic objectives" are to restore Iraq's political and economic stability by means of infrastructure development, and to transition to host-nation support within two years.

Although the PMO's functions and objectives are well defined, its legal status and future role are less clear. The PMO is part of the CPA, not the US Government. While the PMO will survive the planned dissolution of the CPA in June 2004, its legal status following the transition has not yet been determined. The impact of this circumstance on contractors is uncertain.

The fact that such high-level legal issues have not yet been resolved in the context of the Iraq reconstruction process may be discomfiting, but it is not surprising. This effort constitutes the most diverse involvement of private contractors in a military-based objective ever to occur. For many contractors, the legal issues in the Iraq reconstruction have appeared voluminous and daunting. This situation has created a perceived risk which, by itself, has kept some businesses on the sidelines.

The legal landscape was partially cleared when reconstruction officials decided to have US agencies, and not the CPA, award the bulk of the contracts funded directly by US appropriations. This decision was initially made for practical reasons—the CPA and PMO simply did not have the contracting mechanism in place to handle the volume of work—but the legal ramifications are more significant.

All of the solicitations issued in early January 2004 identify the contracting agency as either the US Army Corps of Engineers (USACE) or the Pentagon Renovation Program (PENREN) of the Office of the Secretary of Defense. Having USACE and PENREN award and administer the contracts brings nearly unparalleled construction contracting expertise to the Iraq reconstruction process. It also avoids issues relating to:

- Succession of contracts when the CPA is dissolved;
- Determining whether US laws, the Federal Acquisition Regulation (FAR), and other legal requirements apply to the contract, as opposed to an uncertain combination of US and Iraqi laws; and
- The applicable process for resolving contract disputes.

Thus, USACE, PENREN, and other US agencies will award and administer US funded contracts, and the PMO will manage the effort. The PMO also has subordinate Sector PMOs (SPMO) that are aligned with certain commodities and that mirror the current structure of the Iraqi ministries. The SPMOs are responsible for defining specific projects, establishing priorities, managing design and construction, and commissioning projects. In this role, the SPMOs will co-ordinate with the US

<sup>10</sup> The Iraqi ministries are also awarding contracts, and funding for additional contracts are also coming from the Madrid Conference and other sources. These are not the focus of this article.

<sup>11</sup> See CPA Regulation No.2, "Development Fund for Iraq", June 10, 2003, available at: [www.cpa-iraq.org/regulations/REG2.pdf](http://www.cpa-iraq.org/regulations/REG2.pdf).

contracting agencies and Iraqi ministries, other coalition partners, and contractors to guide the reconstruction efforts.

#### 4. The Contract Vehicles

The solicitations published in early January 2004 are for seven program management service contracts and 10 major Iraq reconstruction contracts. The total value of the current solicitations is approximately \$5 billion, and contract awards are expected by March 2004.<sup>12</sup>

The program management solicitations, issued by PENREN, are anticipated to result in seven contracts. One contract will be for program management support to the PMO, facilitating overall program co-ordination and management. The remaining six contracts will be for SPMO support, with contractors playing a significant role in managing the reconstruction efforts.

The construction solicitations were issued by USACE and will be co-ordinated through its Transatlantic Program Center. They are anticipated to result in 10 design-build, cost-type, indefinite-delivery, indefinite-quantity (ID/IQ) prime contracts for a two-year base period with three one-year options. The bulk of the funds will be spent on quality-of-life projects. The estimated total dollar values of the current reconstruction solicitations are as follows:

- Electrical—\$5.6 billion
- Public works/water—\$4.4 billion
- Security/justice/safety—\$0.6 billion
- Transportation/communication—\$0.5 billion
- Oil—\$1.9 billion
- Building/health—\$1.2 billion

The 10 design-build construction contracts will be divided by discipline or by region, depending on the requirements within each sector. Each scope of work included in a solicitation is general in its description, providing types of tasks, minimum standards, and administrative functions. Task orders will be issued as projects are identified by the SPMOs.

Awards will be made to the best overall (*i.e.* best value) proposals that are determined to be most beneficial to the Government, based on the evaluation of technical, management, past performance, and cost factors. Each cost proposal will be based upon a contract cost model with various labour rates, and a sample task order representing a hypothetical project. The contractor will complete a cost reimbursement cost estimate based on the facilities and assumptions included in the relevant scope of work and technical requirements. The Government does not plan to conduct discussions with offerors prior to contract award.

Once a contract is awarded for a particular discipline or region, that contractor will receive all of the task orders within that discipline/region.<sup>13</sup> To ensure that the selected contractor can perform in this

<sup>12</sup> In addition to the current solicitations, contracts for the balance of the \$18.6 billion appropriation will be for a variety of other needs and are expected to be solicited over the next two years. In fact, the PMO anticipates approximately \$5 billion in procurement actions for goods and services unrelated to construction. The prime contract vehicles, therefore, will provide diverse opportunities for contractors and subcontractors.

<sup>13</sup> Certain Members of the US Congress have criticised this approach as creating monopolies within each discipline/region. They wish to see competition conducted on a project-by-project basis. See Letter from Congressmen Waxman and Dingle to Secretary Rumsfeld, December 18, 2003, available at: [www.henrywaxman.house.gov/pdfs/pdf\\_nash\\_12\\_18\\_03.pdf](http://www.henrywaxman.house.gov/pdfs/pdf_nash_12_18_03.pdf).

indefinite circumstance, the solicitations are geared toward large, sophisticated companies with demonstrated expertise and experience. It is clear that the reconstruction procurement officials intend to rely heavily on their prime contractors to manage this work.

One consequence of the large ID/IQ prime contracts is substantial subcontracting opportunities. Prime contractors may subcontract up to 88 per cent, and must subcontract at least 10 per cent, of the total contract value. The overall subcontracting goal is 23 per cent, and offerors will be evaluated by this standard.<sup>14</sup>

While the subcontracting opportunities seem limitless, most subcontractors have encountered difficulty identifying opportunities and aligning themselves with prime contractors. The Government is taking a hands-off approach to this process. The list of potential prime contractors is considered source selection information and will not be released. This leaves most subcontractors searching for ways to participate, and often turning to consultants (with varying levels of expertise and contacts) for assistance.

## 5. Significant contracting and legal issues

The contracts awarded by US agencies are governed by US procurement laws and regulations. All qualifying companies wishing to participate in these contracts must have a basic understanding of these legal and contracting requirements.<sup>15</sup> Additionally, there are significant Iraq-specific issues of which potential prime and subcontractors should be aware. This section describes these unique issues.

### 5.1 Cost-type contracts

The design-build contracts are cost-type because, according to the solicitations, anticipated technical and performance risks can only be mitigated through such contract vehicles. Fixed-price task orders may be used at a later date, if technical, cost, and schedule risks diminish sufficiently.

### 5.2 Eligible participants

Although the Competition in Contracting Act (CICA) generally requires full and open competition for federal procurements, it provides seven exceptions to this requirement.<sup>16</sup> One such exception exists “when the agency head determines that it is not in the public interest in the particular acquisition concerned.”<sup>17</sup> The Iraq solicitations rely upon this “public interest exception” to limit the competition for prime contractors to sources from eligible countries (*i.e.* United States, Iraq, coalition partners, force contributing nations, and Canada). Furthermore, the offeror cannot be a subsidiary

<sup>14</sup> It is the policy of the Federal Government that small business concerns have the maximum practicable opportunity to participate in performing contracts awarded (and subcontracts thereunder) by any federal agency.

<sup>15</sup> An excellent “Federal Government Contract Overview”, written by Government Contracts attorney and professor, Carl Vacketta, can be found at: <http://profs.lp.findlaw.com/govt/index.html>.

<sup>16</sup> See, 10 U.S.C. s.2304(c); FAR 6.302.

<sup>17</sup> See, FAR 6.302-7.



(wholly-owned or otherwise) of a parent that is organised under the laws of a non-eligible country. This restriction does not apply to subcontractors at any level.<sup>18</sup>

The Pentagon's decision to limit "eligible" prime contractors to supporting countries was announced in December, frustrating countries that opposed the war such as France, Russia, and Germany.<sup>19</sup> Under traditional US legal standards, this decision probably would not be set aside unless it were found to be arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.<sup>20</sup> On the other hand, some critics have suggested that the exclusion of non-ally nations firms' is antithetical to the underlying principles of the World Trade Organisation's (WTO's) Government Procurement Agreement (GPA).<sup>21</sup> Only time will tell whether a member country will challenge the Bush administration's actions under the WTO or GPA regimes.

### 5.3 Accounting systems

Potential prime contractors will generally be required to have accounting systems that comply with the Cost Accounting Standards<sup>22</sup> and the FAR Pt 31 cost principles,<sup>23</sup> and that will support the submission of cost and pricing data under the Truth-In-Negotiations Act.<sup>24</sup> These requirements will also apply to many subcontractors, although the use of commercial-item subcontracting is permitted and would serve to eliminate these accounting system requirements, for qualifying contracts.

<sup>18</sup> The Pentagon's decision to limit the "eligible" prime contractor to supporting countries was announced in December, frustrating countries that opposed the war such as France, Russia, and Germany. See, "Determination and Findings", Deputy Secretary of Defense, December 5, 2003, available at: [www.rebuilding-iraq.net/pdf/D\\_F.pdf](http://www.rebuilding-iraq.net/pdf/D_F.pdf); see also Douglas Jehl, "U.S. Bars Iraq Contracts for Nations That Opposed War," *New York Times*, December 9, 2003. Nevertheless, the "public interest exception" is available by statute and regulation. As long as the procedural requirements for applying the exception are met (i.e. a written determination in accordance with FAR 1.704 and timely notification of Congress), the decision to apply the exception will not be set aside unless it is found to be arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law. See *Varicon International v OPM*, 934 F.Supp. 440, 445 (D.D.C. 1996).

<sup>19</sup> See "Determination and Findings", Deputy Secretary of Defense, December 5, 2003, available at: [www.rebuilding-iraq.net/pdf/D\\_F.pdf](http://www.rebuilding-iraq.net/pdf/D_F.pdf); see also Douglas Jehl, "U.S. Bars Iraq Contracts for Nations That Opposed War," *New York Times*, December 9, 2003.

<sup>20</sup> This standard of review likely would be satisfied if DOD followed the procedural requirements for applying the CICA exception (e.g. a written determination in accordance with FAR 1.704 and timely notification of Congress). See *Varicon International v OPM*, 934 F.Supp. 440, 445 (D.D.C. 1996).

<sup>21</sup> See GPA at: [www.wto.org/english/tratop\\_e/gproc\\_e/gp\\_gpa\\_e.htm](http://www.wto.org/english/tratop_e/gproc_e/gp_gpa_e.htm).

<sup>22</sup> The contractor's cost accounting practices must comply with 19 specific Cost Accounting Standards (CAS) (if subject to "full" coverage) or four Standards (if subject to "modified" coverage). The CAS necessitate changes to the cost accounting systems typically relied upon by commercial businesses and requires disclosure of a company's current cost accounting practices in a formal Disclosure Statement. See, FAR 52.230-2. From a practical viewpoint, these requirements may exclude companies without a CAS-compliant accounting system from competing for prime contracts and many subcontracts.

<sup>23</sup> The cost principles, contained in FAR Subpart 31.2, include general guidance regarding the allocation of costs, provide administrative guidance, and address categories of cost that are either unallowable or for which allowability is qualified or limited in some respect. These principles require the company to establish an accounting system that identifies and excludes unallowable costs from proposals and invoices to the government.

<sup>24</sup> When applicable, the "TINA" and the implementing clauses require contractors to submit "cost or pricing data." See, 10 U.S.C. s.2306a; 41 U.S.C. s.254b. The information embraced by the term "cost or pricing data" includes "all facts . . . prudent buyers and sellers would reasonably expect to affect price negotiations significantly." FAR 15.401. Failure to provide accurate, current or complete cost or pricing data will result in a contract price reduction and possible criminal prosecutions. The requirement must be flowed down to subcontractors at all tiers unless they separately qualify for an exemption.

#### **5.4 Secondary Arab boycott of Israel**

By submitting an offer, a contractor certifies that it does not comply with the Secondary Arab Boycott of Israel and will not take actions with respect to that boycott in violation of 50 U.S.C. App. 2407(a).

#### **5.5 Choice of law and forum**

The contractor must agree to waive any rights to invoke the jurisdiction of local national courts where the contract is performed. It must also agree to accept the exclusive jurisdiction of the United States Armed Services Board of Contract Appeals and the United States Court of Federal Claims for the hearing and determination of any and all disputes that may arise under the Disputes clause of the contract.<sup>25</sup>

#### **5.6 Alternative dispute resolution**

The solicitations require offerors to agree to use non-binding alternative dispute resolution techniques, as well as time period “guidelines” for resolving disputes. The available ADR methods include mediation, early neutral evaluation, mini-trials, and the use of an Executive Dispute Resolution Committee or a Dispute Resolution Board.

#### **5.7 Bid protests**

Normal bid protest procedures and jurisdiction will apply to the current solicitations. However, the Government has indicated its intent to override any stay of contract performance pending resolution of the bid protest.

#### **5.8 Contract direction**

The Government is advising that prime contractors should take direction only from the US agency contracting officers. The PMO, however, will be managing the projects, and the Iraqi ministries will most likely have input into some issues. This fact—combined with common command and control issues in a wartime environment—could create constructive changes, *i.e.* judicially-recognised, compensatory changes that often result from conflicting directives.

#### **5.9 Origin requirements**

The most common domestic preference law in the US—the Buy American Act<sup>26</sup>—does not apply to procurements of “products or services for use outside the United States,” so it will have limited applicability to these contracts. However, certain “Little Buy American Act” domestic preferences are included in the solicitations.<sup>27</sup>

<sup>25</sup> Disputes under government contracts are governed by the procedures set forth in the Contract Disputes Act of 1978 (CDA), 41 U.S.C. ss.601 *et seq.* The CDA designates the two identified forums to resolve contract disputes. Neither forum provides for jury trials. State courts and federal district courts are not available.

<sup>26</sup> 41 U.S.C. ss.10a through 10d.

<sup>27</sup> The solicitations incorporate Defense Federal Acquisition Regulation Supplement Clauses 252.225–7012, 252.225–7016, and 252.225–7030, all of which provide preferences with regard to the origin of certain goods.

### **5.10 Real estate**

Many contractors will need to establish an office in the Middle East. To date, contractors working in Iraq have favoured Dubai, Abu Dhabi, Amman, and Kuwait City, all of which have commercial real estate laws developed to varying degrees. Those planning to move into Iraq will find a real estate market in the process of a massive transformation. A land rush in Baghdad is just beginning, and prices around the projected sites for the SPMOs are skyrocketing.

### **5.11 Iraqi participation**

A swift transition of the reconstruction effort to Iraqi management and control is one of the principal objectives of the contracts. To that end, contractors are expected to involve local Iraqi firms and individuals in significant roles in order to facilitate future transfer of knowledge, skills, and abilities. Contractor efforts to maximise Iraqi participation in the reconstruction effort will be a significant part of the award fee evaluation. The contractors will be required to provide training to the Iraqi workforce on the operation and maintenance of all infrastructure facility components, and to have bilingual (English and Arabic speaking) representatives to serve as translators and trainers.

### **5.12 Construction standards**

British construction standards form the basis for Iraqi standards and, therefore, will apply to these reconstruction contracts. Project-specific standards will be included in the task orders.

### **5.13 De-Baathification**

Contractors may not employ or subcontract with any persons determined under procedures promulgated by the Iraqi Governing Council to be full members of the Baath Party or certain other affiliated organisations.<sup>28</sup>

### **5.14 Associate contractors**

Contractors will be required to co-operate with each other across sectors, “to ensure that contractors accomplish their assigned tasks in the most cost effective and expedient manner, while maintaining an overall program perspective.”

### **5.15 Security**

Contractors must provide security for their personnel, equipment, and material in co-ordination with the military units in Iraq. As weekly news reports indicate, attacks on contractor personnel and equipment in Iraq have not ceased with the end of major combat operations. Injuries to contractor personnel and theft of equipment are, regrettably, all too common in this environment.<sup>29</sup> Private security forces, however, have been able to assist contractors to meet this requirement.

<sup>28</sup> See CPA Order No.1, “De’Baathification of Iraqi Society”, May 16, 2003, and the corresponding implementation plan and delegations of authority, available at: <http://cpa-iraq.org>.

<sup>29</sup> Even the US Government and the CPA are contracting for certain of their personnel security. Kroll Worldwide, Inc., has been hired by the US Agency for International Development to protect its officials, and by the CPA to protect the recruiting and training of the new Iraqi military. In the interest of full disclosure, the author has represented Kroll in establishing both contractual relationships.

### **5.16 Insurance**

Contractors must maintain adequate insurance, including general commercial liability, workers' compensation, and War-Hazard Insurance coverage. All US and major foreign national firms must provide Defense Base Act coverage to all employees, including foreign national subcontractors and host nation employees. Many contractors and subcontractors interested in Iraq reconstruction contracts, however, have found that their current insurance companies have refused to issue, or have substantially increased premiums for, insurance coverage related to activities in a war zone.

### **5.17 Organisational conflicts of interest (OCI)**

The solicitations for PMO and SPMO program support strongly caution offerors about potential conflicts of interest that could result from performance of these functions in relation to other contracting opportunities in Iraq. To avoid obvious OCIs,<sup>30</sup> the successful offeror for the PMO support contract will not be awarded any prime contracts for SPMOs or any design-build construction contracts. In addition, the successful offeror for an SPMO support contract cannot be awarded a design-build construction contract within that SPMO sector.

### **5.18 Legal compliance in this politically-charged environment**

Most government contractors have programs in place to ensure compliance with procurement laws and regulations. Nevertheless, Iraq contracts bring an elevated level of scrutiny, from investigations and increased audits to harmful speculation from those attempting to gain publicity. Furthermore, the amount of money being spent in Iraq has created an environment ripe with opportunities for malfeasance. Criminal and civil violations are occurring—intentionally or otherwise. In this highly charged political atmosphere, contractors must effectively manage not only their compliance programs, but the public relations aspects of the situation, as well.

Beyond these significant legal and contracting issues, contractors and subcontractors should expect the customary US procurement practices to be modified based on security concerns, geopolitical influences, and the unpredictable wartime environment.

## **6. Conclusion**

The private sector is playing an unprecedented role in Iraq. The reconstruction of Iraq is among the largest rebuilding efforts in history, and contractors are involved in almost every aspect of this endeavour. Businesses accustomed to US procurement standards will have a unique competitive advantage, if they can remain flexible and stay on top of the still-evolving contracting process.

<sup>30</sup> OCIs arise when work performed by a contractor's business unit under a government contract creates the potential for an unfair competitive advantage or may impair the business unit's objectivity in performing another government contract. See FAR Subpart 9.5.

## *Ireland*

# The Use of Minimum Pre-qualification Criteria: The *Whelan Group* Case, Judgment of the Irish High Court of March 9, 2001

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The case of *Whelan Group (Ennis) Ltd v Clare CC*<sup>1</sup> involved a challenge by the Whelan Group to the tendering procedure adopted by Clare County Council in respect of major road improvement works planned for the Newmarket-On-Fergus area of County Clare (the “proposed works”).

In February 2000, Clare County Council published a Contract Notice in the *Official Journal* and in an Irish newspaper in respect of proposed works whose value was estimated at IR£25 million. The Notice made it clear that the council was adopting the restricted procedure for the award of the contract. The Notice provided, in this regard, that applicants would be required to complete a pre-qualification questionnaire which requested information concerning the applicant’s financial and economic standing and technical knowledge and ability.

The questionnaire provided, *inter alia*, that:

“the minimum relevant experience shall be judged on the Contractor’s record during the period 1995 to 1999 inclusive. Evidence of that record shall be furnished, with the attached pre-qualification questionnaire. The Contractor shall as a minimum, have satisfactorily completed: Roadworks project, value exceeding IR£10,000,000, excl. VAT for any one individual project.”

The questionnaire provided that any applicant who did not comply with the specified minimum of pre-qualification criteria set out in the questionnaire would be excluded from further consideration.

The Whelan Group obtained a copy of the pre-qualification questionnaire and returned it, duly completed, to the council. In its replies, it stated it had carried out road and bridge works for the County Councils of Cork, Limerick and Offaly to the value of IR£11,900,000. The council discovered, on examining the questionnaire, that the Whelan Group had not in fact carried out an individual project to the value of not less than IR£10,000,000. The largest contract value of works carried out had a tender price of IR£3.9 million. On that basis, the council took the view that the minimum criteria specified in the questionnaire had not been met and did not invite the Whelan Group to submit a tender.

The Whelan Group challenged that decision on the basis that it infringed principles of EU public procurement law, particularly those that prohibit discrimination, inequality of treatment, lack of

<sup>1</sup> [2001] IEHC 33.

transparency and lack of proportionality. The Whelan Group sought a series of declarations from the High Court (presumably, although not stated, under the European Communities (Review Procedures For The Award Of Public Supply And Public Works Contracts) Regulations, 1992—1994) to the effect that the council was in breach of its obligations and furthermore sought an Order removing the requirement that a contractor should have completed one individual project to the value of IR£10 million.

In his Judgment of March 9, 2001, Kelly J. held that the Whelan Group was not entitled to the reliefs which it sought and dismissed the proceedings.

He was satisfied that the criterion in question was included on the advice of an expert standing committee, which took the view that the criterion was necessary having regard to the financial and technical complexity of the project. Furthermore, it was taken in accordance with the practice determined by the National Roads Authority.

As the criterion applied to all potential contractors, Kelly J could not see how it could be said to be discriminatory. He also believed it was an objective criterion as it was capable of objective assessment and application. Furthermore, there was a rational basis for it. Finally, it was transparent because every potential tenderer who was notified of the requirement had to comply with it.

Kelly J. noted that the EU Directive in question, the Public Works Directive 93/37/EEC, did not set out the specific technical or economic criteria that were to be applied in the context of the restricted procedure. However, the Directive did recognise (in Art.22) the use of minimum conditions as a basis for selecting candidates using the restricted procedure. These minimum conditions could be of an “economic and technical nature”. In his view, therefore:

“as evidence can be sought as to the value of works performed by the contractor in the preceding five years it must be the case that the value of those works can be used as a minimum condition provided of course that there is an objective and non-discriminatory basis for choosing such a criterion. In my view there is in this case both an objective and non-discriminatory basis for choosing the criterion”.

He rejected the suggestion that the criterion did not relate to technical ability.

Finally, Kelly J. was satisfied that the criterion “did not suffocate genuine competition”. Although the Whelan Group was excluded because of its inability to comply with the criterion, Kelly J. believed that the stipulation was proportionate, had a rational basis, and was applied objectively. Therefore, it did not, in his opinion, offend against the requirements of Community law.

The case has been appealed to the Supreme Court, but has not been heard as yet.

This case confirms that under Irish law, it is open to contracting authorities to set minimum criteria to be met by potential tenderers at the pre-qualification stage, provided they comply with the relevant Directive and EC law generally, are applied in an objective manner, and are rational, proportionate, non-discriminatory and transparent.

## *United Kingdom*

### Office of Fair Trading 9

#### **Bodies that purchase goods or services, but are not engaged in their direct provision**

27 Having regard to the above legal position, the OFT considers that generally where a public body is only a purchaser of goods or services in a particular market and is not involved in the direct provision of any goods or services in that market or a related market, that body will not be an undertaking for the purposes of the CA98.

#### **Bodies that are engaged in the purchase and direct provision of goods or services**

28 The legal position with regard to public bodies which both purchase and directly provide goods or services for non-economic purposes (for example purposes which are purely social, environmental or national security related) is unclear and in a state of development, with a number of important judgments on the subject awaited. The OFT considers that the best use of its resources is to await clarification of the law rather than immediately to examine such cases on an individual basis under the CA98.

29 This is not to say that the OFT will not examine markets in which purchasing and provision by a public body for non-economic purposes may be causing anti-competitive effects, rather that in circumstances where such cases raise broader issues there may be other more suitable, flexible and effective methods of examining these markets, which deploy the OFT's resources more efficiently. For example, the OFT is examining a "super-complaint" regarding care homes at the moment and, as a separate exercise, is conducting preliminary analysis into a review of government purchasing.

30 Accordingly, in the absence of exceptional circumstances, the OFT is unlikely to take such cases forward as CA98 investigations for the time being.

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