

# PPPs in an International Legal, Economic and Political Perspective

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# Public-Private Partnerships

*An international analysis -  
from a legal and economic perspective*



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The EU Asia Inter University Network for Teaching and Research in Public Procurement Regulation was led by University of Nottingham (Project leader: Professor Sue Arrowsmith) and the other consortium members are Copenhagen Business School, the University of Copenhagen, the Central University of Finance and Economics (Beijing), Xinjiang University, and the University of Malaya.

## **Preface**

This book provides a legal, economic and policy analysis of Public Private Partnerships. It is designed as a text for students at university level, but also for lawyers, procurement officials and policy-makers. The book consists of an EU, a WTO and a Chinese legal perspective. As explained on the cover page, the book was prepared as a part of a collaborative project in higher education, the EU Asia Inter University Network for Teaching and Research in Public Procurement Regulation 2009-2011, funded by the EU. This project involved several universities in Europe and Asia and has sought to promote and support the teaching of public procurement in Europe, Asia and globally. This text is one of five books produced under the auspices of the project that are designed to be used as resources in the teaching of public procurement law and regulation. The main editors and chapter authors are listed below, but it should be recognised that the text is a collaborative effort of all the partners to the extent that it has benefited from input by, and discussions between, many different persons at the different partner institutions. In addition to the authors and editor mentioned below, the text has benefited from editing and proof reading by Laura Graham at the University of Nottingham and text assistance from Marie Pade Andersen , Cecilie Voss and Kim Jørgensen at Copenhagen Business School whose assistance the project would like to acknowledge gratefully.

The contents of the book are up to date as of August 2010. It has also been possible to include later developments in some parts of the book.

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## **Part I – Introduction**

## Chapter 1

### Presentation of the book

#### 1. Introduction to Public-Private Partnership (PPP)

In most countries, the government, combined with the agencies it controls, is the biggest purchaser of goods of all kinds, ranging from basic commodities to high-technology equipment. In light of this, the political pressure to favour domestic suppliers over their foreign competitors can be very strong. Traditionally, the focus of international trade agreements has been on market access but many developing countries have opposed the launch of negotiations to extend the principle of nondiscrimination to procurement.

PPPs have a long history in the EU as well as in China, and today, PPPs have received a boost in various countries undergoing processes of significant economic growth. By using PPP it is possible to: provide additional capital; set up alternative management procedures and implementation skills; provide added value to the citizens and the public area; and provide better identification of needs and optimal use of resources.<sup>1</sup>

The market for PPP, and co-operation between the public and private sectors for the development and operation of infrastructure for a wide range of economic activities has increased. Years ago, PPP arrangements were only driven by limitations in public funds to cover investments needs, but today PPP is also driven by the interest of increasing the quality and efficiency of public services in general.

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<sup>1</sup> See European Commission, *Guidelines for Successful Public-Private Partnerships* (March 2003), p. 4.

Neither national legislation<sup>2</sup> nor the EU or WTO has legal rules that specifically cover the PPP arrangement in regard to public contracts rules.

## **2. Purpose of the PPP book**

The PPP book will provide a resource for teaching and research in the area of PPP and public infrastructures in an UN/WTO, EU and Chinese context.

The purpose of the PPP book is to analyse and describe the UN/WTO, EU and Asian regulations concerning PPP, and to discuss the economic and regulatory purpose of PPP and the potential conflict between EC procurement rules and PPP. It further aims to describe the background of PPP in an international perspective and in an EU and Asian perspective, and assess the economic reasoning behind PPP.

The first part of the book will provide a framework for analysing PPP and explain the purpose of PPP. The PPP projects are often based on an economic foundation. One purpose of PPP is to provide a new and more efficient model of providing infrastructure to the citizens. This is based on the idea that taking advantage of private sector experience with infrastructure projects will create the best and the economically most efficient model for the Member State. This will also be addressed, discussed and analysed in part I of the PPP book.

This book will also conduct three legal analyses of PPP. There will be analysis and explanation of: the WTO and GPA provisions concerning PPP from an international perspective; the EU procurement regulation concerning PPP (national court cases from the UK and EU court cases will be used in this legal analysis); and the procurement regulation in China in regard to PPP and concessions.

The need for legal analysis concerning PPP in an international, European and Asian perspective is significant. First, because the experience of the international and European legal systems can be drawn upon in the future development of Asian procurement rules; and secondly, because PPP is still a newly developed concept in many

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<sup>2</sup> A few countries have enacted specific national rules covering PPP: Brazil enacted a PPP act in December 2004, designed to encourage investments for crucially needed infrastructure projects. See Law No. 11.078, D.O.U.31 Dec., 2004 and also C.V. Filho and J.B.Lee, 'Brazil's New Public-Private Partnership Law: One Step forward, Two Step Back' (2005) 22(5) *Journal of International Arbitration* 419426.

European Countries and so the need for information and clarification on the subject is high. Additionally, nations, governments, organisations and companies will be interested in the international perspective due to globalisation and the ongoing growth of international trade. Part II of the book will explore this issue.

Finally, this book compares the legal aspects of PPP with the political and economic situation in Europe and Asia from an international perspective. The use of PPP can develop societies; ensure infrastructure, buildings, hospitals; etc. It is therefore necessary to investigate if the legal provisions restrict or advance the use and development of PPP.

The conflict between the general procurement rules and the economically based PPPs will be discussed and analysed from a legal standpoint. It will be a problem if the procurement rules are being interpreted too strictly because the PPPs may no longer be economically efficient. the concessions as an alternative to PPP will also be discussed.

The final part of this book (Part III) will discuss the PPP law and regulation, and the PPP and procurement policy making, a discussion which will be useful to national and EU policy makers, lawyers, procurement officials and suppliers.

Thus, this book will describe how PPPs can present a number of advantages to both the industry and countries in general. The book will introduce and present the rules governing PPP in the EU and China and countries using the WTO and GPA concerning PPP. Both government and industry can profit from the advantages of PPP by enhancing their understanding of PPP arrangements. The book will seek to provide legal, economic and managerial skills to optimise the use and understanding of PPP.

### **3. Asia link collaboration**

The PPP book is part of a research project that is establishing an EU-Asia inter-university network for teaching and research in public procurement regulation. The project consists of the University of Nottingham in the UK and the Copenhagen Business School in Denmark, the Central University of Finance and Economics (CUFE), Xinjiang University in China and the University of Malaya.

The aim of the research project between these universities is directly relevant to ensuring high-quality infrastructure; securing

adequate public services in areas such as health, utilities and sanitation; and fighting corruption. Effective procurement regulation and understanding of the benefits of PPP can integrate environmental policies into procurement; facilitate development of competitive markets (particularly important for transition economies); promote electronic commerce; and achieve equality between citizens (race, gender, etc).

The research project will create a sustainable pool of expertise on procurement regulation in Asia and in Europe. This will provide a multi-level training, research and dissemination infrastructure in which the primary target groups of academic staff and postgraduates act as disseminators to the broader group of the government procurement community. This community will participate through conferences, as readers of journals and other publications, and from direct academic input into policy-making. The PPP book is part of the effort towards creating expertise in regard to public procurement regulation.

Christina D. Tvarnø, Associate Professor, PhD, Law Department, Copenhagen Business School, holds the editorial responsibility for the PPP book. The PPP book is produced in collaboration between researchers from Copenhagen Business School (Christina D. Tvarnø and Henrik Andersen, Post.doc, PhD), Nottingham University (Ping Wang, Lecturer, and PhD) and CUFE (Fuguo Cao, Professor, PhD).

#### **4. Structure of the book**

The book contains three parts: Part I – Introduction, Part II –Legal analysis and Part III – Discussion.

Chapter 1 presents the scope of the book, beginning with a brief presentation of the purpose, structure and methods used in the book. The chapter is written by Christina D. Tvarnø.

Chapter 2 presents the PPP concept and describes the background of PPP. The chapter also discusses the difference between a traditional public project and a PPP. A PPP project is based on an economic foundation alternative to what is traditionally seen in public procurement projects. One purpose of PPPs is to provide a new and more efficient model of providing infrastructure to the citizens. The PPP is based on the idea that the experience from the private sector used in infrastructure projects will create the best and economically



most efficient model for the governments. The chapter is written by Christina D. Tvarnø.

In Chapter 3, the WTO and the GTA agreements are analysed and discussed. The chapter is written by Henrik Andersen.

Chapter 4 describes the EU and the British procurement regulation. PPP projects within the European Union will typically fall under these procurement rules and in this chapter the EC procurement rules and their influence on, and implications for, the PPP will be introduced and analysed. The chapter is written by Ping Wang.

In Chapter 5, the Chinese rules concerning PPPs are introduced and analysed. The UNCITRAL Legislative Guide on Private Finance in Infrastructure Projects will be explored in a Chinese context. The chapter is written by Fuguo Cao.

Chapter 6 discusses PPPs in an international legal, economic and political perspective. In this chapter, the purpose of PPPs in an economic perspective will be discussed in relation to the aim of the legal purpose. The chapter discusses how the national regulation, EU law and international law could support the economic idea of PPP and the need for economically valid and efficient solutions to create infrastructure. The chapter is written by Christina D. Tvarnø.

## **5. Teaching and research**

The PPP book will provide a resource for teaching and research in the area of PPP and public infrastructures from an international, European and Asian procurement perspective.

The PPP book is to be used by the participating institutions in their teaching modules. Students in other EU Member States and in other Asian countries may also benefit from this book. The PPP book will be a valuable, basic international resource for academics and PhD students. It provides an important international tool for both academics and companies interested in the PPP rules. The economic and political explanations may be beneficial to parties and countries that use or consider using PPP.

The PPP book will present different legal systems by the method used in this regard.

## 5.1 The legal analysis of the EU rules

Most of the national procurement legislation in the Member States is derived from EU law, from both the EC Treaty and the procurement directives. The EC procurement law is based on the common market and the elimination of barriers to trade in goods and to movement in business, labour and capital between Member States. The political and economic reasoning behind the common market is based on the economic theory of comparative advantages.<sup>3</sup>

The purpose of the EC Procurement law is to ensure an opening up of the public procurement market.<sup>4</sup> The EC public procurement rules apply to purchases by public bodies which are above set monetary thresholds. They cover all EU Member States and, as a result of international agreements, their benefits also extend to several other countries worldwide.<sup>5</sup>

The EC procurement Directives set out the legal framework for public procurement. The Directives apply when public authorities and utilities seek to acquire goods, services, civil engineering or building works. Importantly when considering PPP, the principles in the EC

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<sup>3</sup> See P. Krugman and M. Obstfeld, *International Economics, Theory and Policy*, (6<sup>th</sup> ed., Boston: AddisonWesley, 2003), part I.

<sup>4</sup> S. Arrowsmith, *The Law of Public and Utilities Procurement*, (2<sup>nd</sup> ed., London: Sweet & Maxwell, 2005), p. 121. See also S. Arrowsmith, 'Public Private Partnerships and the European Procurement Rules: EU Policies in Conflict?' (2000) 37 *Common Market Law Review* 709-737, p. 709; S. Arrowsmith, *The Law of Public and Utilities Procurement*, (2<sup>nd</sup> ed., London: Sweet & Maxwell, 2005); M. Burnett, *Public-Private-Partnerships (PPP) – A Decision Maker's Guide* (Maastricht: Institut Européen d'Administration Publique, 2008); S. E. Hjelmberg, P. S. Jakobsen and S. T. Poulsen, *Public procurement law – the EU Directive on public contracts* (Copenhagen: Djøf, 2006); R. Nielsen, *Udbud af offentlige kontrakter* (Copenhagen: Jurist- og Økonomforbundets Forlag, 2005); and M. Steinicke and L. Groesmeyer, *EU's udbudsdirektiver* (Copenhagen: Jurist- og Økonomforbundets Forlag, 2008).

<sup>5</sup> Where the Regulations apply, contracts must be advertised in the Official Journal of the European Union (OJEU), and there are other detailed rules that must be followed. The rules are enforced through the courts, including the European Court of Justice (ECJ). Even when a tender process is not required under the Directives, for example because the estimated value of a contract falls below the relevant threshold, EU Treaty-based principles of non-discrimination, equal treatment, transparency, mutual recognition and proportionality apply, and some degree of advertising, appropriate to the scale of the contract, are likely to be necessary to demonstrate transparency.

Treaty and the procurement rules in the procurement Directives set out rules and procedures which must be followed before awarding a contract of a value that exceeds set thresholds. The EC rules do not lay down any specific rules in regard only to PPP.<sup>6</sup>

There are several positive elements in the EC procurement rules. One is the possibility to eliminate a corrupt governmental practice; another is that effective public procurement is essential for good public services and good government. The procurement rules ensure that the government applies the highest professional standards when it spends money on behalf of taxpayers. This procedure helps to ensure competition as the cornerstone of public sector procurement and to maintain market interest – particularly where a well-established and competitive market does not already exist.

In markets with no or limited competition, the procurement rules can undertake market soundings, be prepared to adapt the requirements to the capacity and capabilities of the marketplace, and advertise and market contracting opportunities as broadly as possible.

The objectives of the specific EC public procurement Directives are to ensure fairness and equal treatment and better procurement practices, open up the competition, and lower the overall prices. The basic principles to obtain these goals are transparency, non-discrimination, equal treatment, proportionality and competition.

The EC procurement law is not only used by the 27 EU Member States. The EU public procurement rules also apply to a number of other countries because of an international agreement negotiated by the World Trade Organisation (WTO) titled the Government Procurement Agreement (GPA).<sup>7</sup> With regards to PPP, the legal situation in all Member States is that PPP is a public contract falling within the scope of the public procurement law.

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<sup>6</sup> C. H. Bovis, *EU Public Procurement Law* (Cheltenham: Elgar European Law, 2007), p. 52.

<sup>7</sup> These are Aruba, Canada, Hong Kong, China, Iceland, Israel, Japan, Republic of Korea, Liechtenstein, Norway, Singapore, Switzerland and USA.

## 5.2 The legal analysis of WTO

The WTO's Agreement on Government Procurement (GPA)<sup>8</sup> is the only legally binding agreement in the WTO focusing on the subject of government procurement to date. Its present version was negotiated in parallel with the Uruguay Round in 1994, and it entered into force on January 1<sup>st</sup> 1996.<sup>9</sup> It is a plurilateral treaty administered by a Committee on Government Procurement, which includes the WTO Members that are parties to the GPA and thus have rights and obligations under the Agreement.<sup>10</sup> Apart from procurement rules, the GPA enforces rules guaranteeing fair and non-discriminatory conditions of international competition.<sup>11</sup>

Under WTO law, there is no legal definition of PPP<sup>12</sup> even though several WTO Member States resort to PPP in e.g. infrastructure projects.<sup>13</sup> The importance of legal instruments in regard to encouraging PPP has been recognised in the WTO.<sup>14</sup> The GPA is

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<sup>8</sup> At present the GPA is therefore the only international agreement on Public Procurement in force.

<sup>9</sup> An Agreement on Government Procurement was first negotiated during the Tokyo Round and entered into force on 1 January, 1981. Its purpose is to open up as much of this business as possible to international competition. It was designed to make laws, regulations, procedures and practices regarding government procurement more transparent and to ensure that they do not protect domestic products or suppliers, or discriminate against foreign products or suppliers.

<sup>10</sup> Government procurement is an important aspect of international trade, given the considerable size of the procurement market (often 10 to 15 percent of GDP) and the benefits for domestic and foreign stakeholders in terms of increased competition. Many WTO Members use their purchasing decisions to achieve domestic policy goals, such as the promotion of specific local industry sectors or social groups. Open, transparent and non-discriminatory procurement is generally considered to be the best tool to achieve 'value for money', as it optimises competition among suppliers.

<sup>11</sup> For example, governments will be required to put in place domestic procedures by which aggrieved private bidders can challenge procurement decisions and obtain redress in the event such decisions were made inconsistently with the rules of the agreement.

<sup>12</sup> See paper by H. Andersen, Global Telecommunication Services and WTO Law, at: <[www.cbs.dk/law](http://www.cbs.dk/law)> accessed 30 November 2010.

<sup>13</sup> See for instance Brazil, Trade Policy Review, WT/TPR/G/140 of 1<sup>st</sup> November, 2004, point 102; India, Trade Policy Review (revised), WT/TPR/S/182/rev. 1 of 24<sup>th</sup> July, 2007, point IV.5,58,132 and 179; Singapore, Trade Policy Review, WT/TPR/S/202 of 9<sup>th</sup> June, 2008, IV.25.

<sup>14</sup> See Report of the Working Group on Trade and Transfer of Technology to the General Council, WT/WGTTT/9, report of 12<sup>th</sup> December, 2007, point 9.

based on transparency and non-discrimination principles.<sup>15</sup> All suppliers should have the opportunity to apply for procurement of a PPP or other types of public contracts. In accordance with the GPA, the Government must ensure that public contracts are awarded in a non-arbitrary way.

Thus, the GPA is based on similar rules and principles as the EU public procurement law presented above in section 2. Contrary to the EC public procurement Directive, however, the GPA does not consist of procurement procedure rules similar to the competitive dialogue. This means that the special need for co-operation in a PPP and negotiation between the parties with regard to define the needs of the public sector will not be possible within the scope of the GPA.<sup>16</sup>

### **5.3 The legal analyses of UK and EU law**

The analysis in chapter 4 regards both the EU public procurement law and the British public procurement law and the impact these rules have on PPP. There is a difference in the legal framework in Great Britain and in the EU and the chapter will focus on the British legal model and draw some parallels with, and differences to, the EU law.

### **5.4 The legal analysis of Chinese law**

This chapter is based on the research behind an article written by Fuguo Cao, 'Regulating Procurement of Privately Financed Infrastructure in China: a Review of the Recent Legislative Initiatives and the Emerging Regulatory Framework'.<sup>17</sup>

The development of the private sector in China has been gaining momentum following a series of encouraging political and policy initiatives issued at central level in the past years. This chapter analyses, among other issues, how the private sector can use PPP in sectors traditionally monopolised by government or state-owned

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<sup>15</sup> Art. III of the GPA.

<sup>16</sup> See paper by H. Andersen, Global Telecommunication Services and WTO Law, at: <[www.cbs.dk/law](http://www.cbs.dk/law)> accessed 30 November 2010.

<sup>17</sup> C Fuguo, 'Regulating Procurement on Privately Financed Infrastructure in China: A Review of the Recent Legislative Initiatives and the Emerging Regulatory Framework' (2007) 16 (3) *Public Procurement Law Review* 147-173.

enterprises (SOEs) in China, and also the development of Chinese public procurement reform and regulation.

The chapter also consists of several analyses and references to the 1994 UNCITRAL Model Law on Procurement of Goods, Construction and Services, with Guide to Enactment, which was adopted by UNCITRAL on June 15<sup>th</sup>, 1994. The Model Law recognises that certain aspects of the procurement of services are governed by different considerations from those applicable to the procurement of goods and construction.

The UNCITRAL Model Law is not a binding legal instrument, but rather an instrument for national governments to use when implementing public procurement legislation. Public procurement constitutes a large portion of public expenditure in most states and PPP will often fall under such legislation. Also, the UNCITRAL Model Law is a model for legislative provisions on procurement of goods, constructions and services, which are all parts in a PPP project.

The objective behind the UNCITRAL Model Law is to establish procedures designed to foster integrity, confidence, fairness and transparency in the procurement process and also to promote efficiency and competition in procurement, and thus lead to increased economic development. The establishment of model legislative provisions on procurement of services that are acceptable to States with different legal, social and economic systems aims to contribute to the development of harmonious international economic relations.<sup>18</sup>

The UNCITRAL Model Law on public procurement does not contain any rules directly concerning PPP, and nor does it define PPP.

## **5.5. Economic and policy perspective**

Chapter 6 analyses the legal challenges faced with regards to PPP and the legal systems. One challenge is that the EU and the WTO do not recognise the need for special PPP rules and definitions for the purposes of decreasing the transaction cost and increasing the level of legal information. For example, the EC Commission has stated<sup>19</sup> that

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<sup>18</sup> See the notes to the preamble in The 1994 UNCITRAL Model Law on Procurement of Goods, Construction and Services, with Guide to Enactment was adopted by UNCITRAL on June 15<sup>th</sup> 1994.

<sup>19</sup> Commission (EC), ‘Communication on Public-Private Partnerships and Community Law on Public Procurement and Concessions’ (Communication) COM (2005) 569 final, 15<sup>th</sup> November 2005. Based on the analysis in Commission (EC),

there will be no new PPP rules or Directives within the EU in the near future.

The Commission does not take into account that some EU Member States have very limited experiences in PPP and that the general lack of transparency and definitions of PPP can result in fewer PPPs. Today, PPP is used in many countries; in the near future, other countries will also use PPP, but the lack of a uniform award procedure designed for public procurement of PPP projects may result in some nervousness from the public sector. In some situations it may be easier not to use PPP because the level of uncertainty and the transaction costs, as well as the risk of claims, are simply too high. This scenario could pose a future problem for the use of PPP. In Chapter 6, it is discussed whether the EU and the WTO should encourage the use of PPP by transparency and uniformity in this highly regulated procurement area.

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‘Report on the Public Consultation in the Green Paper on Public-Private Partnerships and Community Law in Public contracts and Concessions’ (Staff Working Paper), SEC (2005) 629, 3<sup>rd</sup> May 2005, section 3.1.

## Chapter 2

### Presentation of the PPP concept

#### 1. The background of PPP

Limited public funds, as well as efforts to increase the quality and efficiency of public services, make Public-Private Partnership arrangements attractive. PPPs have been developed in part due to financial shortages in the public sector, and they have demonstrated the ability to harness additional financial resources and operating efficiencies inherent in the private sector.<sup>20</sup> PPPs are often used in infrastructure projects, e.g. in sectors such as transport, public health, education and national security, and provide a wide range of public services, like telecommunication, water plants, financial support, innovative financing, general public services, education and research.

In a general legal context, a PPP can be characterised<sup>21</sup> as a long-term contract arrangement between a public authority and a consortium of private parties based on co-operation, aiming to provide a mechanism for developing public service provision involving significant assets or services for a long period of time. The asset or service is entrusted to the private sector, and a part or all of the funding comes from the private sector. The latter means that the private party in a PPP holds all equity and handles the works,

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<sup>20</sup> See Commission (EC), 'Guidelines for Successful Public Private Partnerships' March 2003.

<sup>21</sup> See Commission (EC), 'Green Paper on public-private partnerships and Community Law on Public Contracts and Concessions' (Green Paper), COM (2004) 327 final, 30<sup>th</sup> April 2004.



operation and maintenance of the project.<sup>22</sup> The PPP contract is, or at least should be, based on needs or functions instead of demands or concrete descriptions.

## 2. The economic background of PPP

PPP is a result of the economic effects of globalisation.<sup>23</sup> One problem created by globalisation was the cost of competing in a global arena because the numbers of competitors increased; the cost of selling products on a global market increased, and the cost of using information technology increased.

Globalisation makes it difficult to maintain market power and market share. A company no longer competes only with national companies, but now also with companies all over the world. Because of the Internet, consumers have had access to all kinds of information and all types of products. Whatever their nationality, consumers have been receiving the same information; they want the same kind of life style and desire the same kinds of products, which has changed the market conduct.<sup>24</sup>

Companies found new ways to compete by entering into joint ventures and strategic alliances<sup>25</sup>, and they explored new types of business strategies by creating the concept of co-operation. This development has enabled companies to ensure higher quality in the product, decrease the cost of Research and Development (R&D), information technology, and sale and distribution, and increase their competitive capacity. The motivation for making a strategic alliance was, and still is, to make a business arrangement that encourages

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<sup>22</sup> See S. Arrowsmith, 'Public Private Partnerships and the European Procurement Rules: EU Policies in Conflict?' (2000) 37 *Common Market Law Review* 709-737, p. 709, and S. Arrowsmith, *The Law of Public and Utilities Procurement*, (2<sup>nd</sup> ed., London: Sweet & Maxwell, 2005), p. 415. See also Commission (EC), 'Green Paper On Public-Private Partnerships And Community Law On Public Contracts And Concessions' (Green Paper) COM (2004) 327 final, 30th April 2004.

<sup>23</sup> C. D. Tvarnø, 'Public private partnership in the European Union', in R. Nielsen and S. Treumer (eds.), *The New EU Public Procurement Directives* (Copenhagen: Djøf, 2005), pp. 183-194.

<sup>24</sup> K. Ohmae, 'The Global Logic & Strategic Alliances', *Harvard Business Review*, March-April 1989.

<sup>25</sup> Y. L. Dos and G. Hamel, *Alliance Advantage, The art of creating value through Partnering* (Boston, Massachusetts: Harvard Business School Press, 1998), Preface, p. 9.

dynamism, collaboration and mutual learning among the parties. Therefore, initial agreements have less to do with success than adaptability to change in the market and in consumer needs.<sup>26</sup>

PPP has been precipitated by the globalisation reflected in the public sector. The structural change has affected the public wealth:

The welfare state can no longer regard itself as having a purely domestic role in an increasingly internationalised world where it is being forced to act more and more like a market player.<sup>27</sup>

The governments in the EU Member States had the same problem as in the private industries - citizens in all the Member States want higher quality and better service but wish to pay less tax. The governmental attention to the market mechanisms and the success of privatisation efforts in several countries increased the interest in PPP.<sup>28</sup> Companies had found ways to compete and meet consumer demand, and the governments needed to find a way to serve the citizens with higher quality and at the same time reduce taxes. Accordingly, partnering, partnership and Public Private Partnership became relevant in the public arena.

The idea of PPP can be dated back to the 1960s when the US government developed a method of stimulating private investments in infrastructures<sup>29</sup>. The idea was to protect public interest while at the same time bringing investment potential and added value from the private sector.<sup>30</sup>

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<sup>26</sup> Y. L. Dos and G. Hamel, *Alliance Advantage, The art of creating value through Partnering* (Boston, Massachusetts: Harvard Business School Press, 1998), Introduction p. 15.

<sup>27</sup> R. Common, 'The East Asia region: Do public-private partnerships make sense?', in S. P. Osborne (ed.), *Public-Private Partnership* (London: Routledge, 2000), p. 135.

<sup>28</sup> N. Pongsiri, 'Regulation and public private partnership' (2002) 15(6) *International Journal of Public Sector Management* 487-495.

<sup>29</sup> See further R.S. Fosler, 'Book Reviews on Brooks, H., et.al. (eds.). 'Public-Private Partnership: New Opportunities for Meeting Social Needs'' (1986) 46 (4) *Public Administration Review* 364-365 and N. Pongsiri, 'Regulation and public private partnership' (2002) 15(6) *International Journal of Public Sector Management* 487-495.

<sup>30</sup> Carr, The Canadian Council for Public Private Partnership, 1998, <http://home.infoamp.net/.partners/exford.html>.

The economic recessions in the 1970s led governments to seek more efficient ways to provide services and infrastructure by contracting out. The USA and Great Britain were particularly fascinated by the privatization movement in the 1980s.<sup>31</sup> The use of public asset sales, outsourcing, and divestitures of state owned enterprises became a vehicle for improved public service in a free market economy.<sup>32</sup>

In Great Britain, the first attempts to establish a new type of contract were based on the problems in relation to the high degree of cost, the lack of competition and constructions of poor quality. In 1998 Sir John Egan presented the report, *Rethinking Construction*,<sup>33</sup> in which partnering was presented as a model for a new type of contract in the construction industry. The Egan report focused particularly on 'lean' production and co-operation, and resulted in the development of the partnering concept.<sup>34</sup> The British Government believed that a change in construction was necessary in order to create better contract conditions in support of better and more efficient buildings. Based on the results of the Egan report, the construction industry ended up with a new contract model using collaboration, negotiation and common utility - the partnering contract. In the report it was proposed that a binding collaborative contract may not be necessary.<sup>35</sup> Today, however, this idea has been abandoned. The first partnering model agreement came in 2000 as a binding contract concept.

Governments in the Member States need new types of co-operation and contract agreements. This is one reason why the PPP contract is based on trust, co-operation and negotiation between the parties and is used when the need for co-operation is high.

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<sup>31</sup> N. Pongsiri, "Regulation and public private partnership" (2002) 15(6) *International Journal of Public Sector Management* 487-495.

<sup>32</sup> D. F. Kettl, *Sharing Power, Public Governance and private markets*, (Washington DC: Brookings. 1993).

<sup>33</sup> Sir John Egan, *Rethinking Construction* (London: Department of the Environment, Transport and the Regions, 1998).

<sup>34</sup> Sir John Egan, *Rethinking Construction* (London: Department of the Environment, Transport and the Regions, 1998).

<sup>35</sup> "Effective partnering does not rest on contracts. Contractors can add significantly to the cost of a project and often add no value for the client. If the relationship between a constructor and an employer is soundly based and the parties recognise their mutual interdependence, then formal contract documents should gradually become obsolete." See Sir John Egan, *Rethinking Construction* (London: Department of the Environment, Transport and the Regions, 1998).

### 3. The aim of PPP

The aims of a PPP contract are to reduce the cost and price; to increase the quality; to reduce the risks and failures; to improve co-ordination; and to share responsibility and capacity. Those objectives result in a shift of content in the contract.

The PPPs can achieve additional value compared with other approaches if there is an effective implementation structure and if the objectives of all parties can be met within the partnership between the public and the private parties.

There is a broad range of options for involving the private sector in public projects, for example, in regard to financing, physical development, operation, transport and environment. In one type of PPP, the public sector may retain all responsibility for financing, constructing, operating and maintaining assets, together with the responsibility for assuming all associated risks. In another type of PPP, the private sector might assume all of these responsibilities. The vast majority of PPP approaches fall in the middle of spectrum, with risks and responsibilities shared between the public sector and its private partners according to their strengths and weaknesses.<sup>36</sup>

In a contract where the risks and responsibilities are shared, the private party is often responsible for the funding, design, completion, implementation, service and maintenance of the project.<sup>37</sup> The incentive to build to reduce the cost of service and maintenance in the long run is heightened because the PPP concept provides the contractor with a compelling reason to create the cheapest building or infrastructure for a period of 20 to 30 years.

Normally, a traditional public contract is based on demands and concrete descriptions. To fulfil the objectives the PPP, the contract focuses on needs and functions, and it must be built on trust, transparency by open books, and co-operation between the parties.<sup>38</sup>

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<sup>36</sup> Commission (EC), 'Guidelines for Successful Public Private Partnerships' March 2003, p. 13.

<sup>37</sup> See Commission (EC), 'Green Paper On Public-Private Partnerships And Community Law On Public Contracts And Concessions' (Green Paper) COM (2004) 327 final, 30th April 2004

<sup>38</sup> Another legal constellation in regard to PPP is the Institutionalised Public-Private Partnership (IPPP). See subsection 5.5. below for a definition of an IPPP.

The European Commission has set out the following reasons for establishing a PPP project.<sup>39</sup>

- the large financing requirement in the environment, infrastructure and transport sectors to upgrade and extend networks in line with the accession requirements and effective service provision
- financial shortfall in available public funds, and the ability of international institutions to cover costs.
- to gain some relevant advantages of PPP, for example:
  - Acceleration of infrastructure provision
  - Faster implementation
  - Reduced whole life costs
  - More optimal risk allocation
  - Improvement of the incentives to perform
  - Improve the quality of service
  - Generation of additional revenues in the private sectors
  - Transferring responsibility and enhanced public management
  - Increasing investments in general
  - Higher efficiency in the use of resources by joint utilities
  - Generating commercial value from public sector assets by joint utilities.

### **3.1 PPP contract terms**

In the end the above mentioned factors can fulfill the main scope of a PPP agreement, which is to ensure joint utility between the parties, thereby ensuring the most efficient product at the lowest price.

In contrast to a traditional public contract, it is the contractor who has the obligation to provide service and operation. The PPP contract must run for a period equal to the time it takes for the private party to regain the investment. This is the main reason for the long duration of PPP projects.

By basing the contract on the needs of e.g. a school project, the public authority focuses on learning strategy, teaching environment, the differences in the learning abilities of pupils, etc. This is different

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<sup>39</sup> Commission (EC), 'Guidelines for Successful Public Private Partnerships' March 2003, p. 15.

from a traditional contract between those kinds of parties, in which the public party would instead focus on number of classrooms, number of square meters, types of furniture and facilities. In a PPP, such decisions are left to the private parties.

This context of public procurement law is relevant because the PPP relationship is between a public and a private party. In many countries this type of relationship normally falls under the scope of public procurement law.

For almost 20 years, the public sector in the EU and e.g. Great Britain have used PPP as an alternative to traditional public contracts, in most cases to great advantage.<sup>40</sup> The use of PPP is still increasing. With its 27 Member States and 500 million citizens, the European Union is a relevant international legal institution as regards Public Procurement Law and the impact on PPP.

In the Green paper on PPP,<sup>41</sup> the EC Commission sets out some elements characterising PPPs. A PPP relationship has a relatively long duration, and involves co-operation between the public partner and the private partner on different aspects of a planned project. In some situations, public funds can be added to the private funds, but mostly the financing and funding comes from the private sector. The economic operator plays an important role, participating in all the different stages of the project (design, completion, implementation, funding). The public partner concentrates primarily on defining the objectives to be attained in terms of public interest, quality of services provided, and pricing policy, and it takes responsibility for monitoring compliance with these objectives.

The distribution of risks between the public partner and the private partner is different. The risks generally borne by the public sector are transferred to the private party if this is efficient with regards to the transaction and the project.<sup>42</sup>

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<sup>40</sup> In Great Britain, PPP is often used in construction and infrastructure projects. Some of the first PPP projects in Great Britain were arranged in 1996 by the Public Private Partnership Programme, the 4Ps. The 4Ps was initiated by the Local Authority Association in England and Wales and has all-Party support. It was launched in April 1996 with the purpose of identifying and assisting in delivering 'pathfinder' projects in key sector areas, e.g. education, social services, IT, etc. to be used as models by other local authorities. See also [www.4ps.gov.uk](http://www.4ps.gov.uk).

<sup>41</sup> See Commission (EC), 'Green Paper On Public-Private Partnerships And Community Law On Public Contracts And Concessions' (Green Paper) COM (2004) 327 final, 30th April 2004, p. 3.

<sup>42</sup> The Commission notes that a PPP does not necessarily entail that the private partner assumes all the risks, or even the major share of the risks linked to the

#### **4. Structure of and parties in PPP projects**

When setting up the framework of a PPP, both the private party and the public party can generate substantial benefits for consumers and taxpayers. To achieve the benefits the parties must create a partnership which ensures that each party delivers what it does best in the most economically efficient manner. It is significant that the structure of the relationship between the parties seeks to provide the aim of value for money. This means, for example, that the structure divides the risks in the projects so the risks are borne by those best able to control them.

In a PPP project, the private party becomes a long-term provider of services and infrastructure instead of simply delivering upfront asset builders. The public and the private party also share the responsibilities of designing, building, operating and possibly financing assets in order to deliver the services needed by the public sector.

Collaboration with a long-term provider results in a new commitment from the public party to become increasingly involved as a regulator and to focus resources on service planning, performance monitoring and contract management rather than on the direct management and delivery of services. It is important to note that public bodies have a critical role to play in the management and regulation of PPPs during their design, construction and operation periods. PPPs also require effective contract monitoring procedures to ensure that contractual obligations continue to be met in terms of both quality and timing.<sup>43</sup>

#### **5. The different types of PPP**

As stated above, neither national law, international law nor EU Community Law has a legal definition of PPP. Both PPPs regarding works and /or services are covered under the detailed provisions of the Public Procurement regulation. The lack of legal definition will be discussed further in chapter 6.

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project. The precise distribution of risk is determined case by case, according to the respective ability of the parties concerned to assess, control and cope with this risk.

<sup>43</sup> Commission (EC), 'Guidelines for Successful Public Private Partnerships' March 2003, p. 17.

The European Commission suggests<sup>44</sup> that:

the principal criteria for distinguishing a concession from PPP is the extent of risk transfer to the private party. This criterion will then also allow each type of PPP to be defined and related to the relevant legislation and methods for selecting private parties.

While the choice of PPP structures is limitless in terms of financial and legal forms, the Commission is of the view that all PPPs can be defined in relation to the rules governing the choice of private partners and the selection and application of public procurement procedures.<sup>45</sup>

The illustration right below presents different types of PPPs; some with a minimal private involvement and some with maximal private sector involvement.

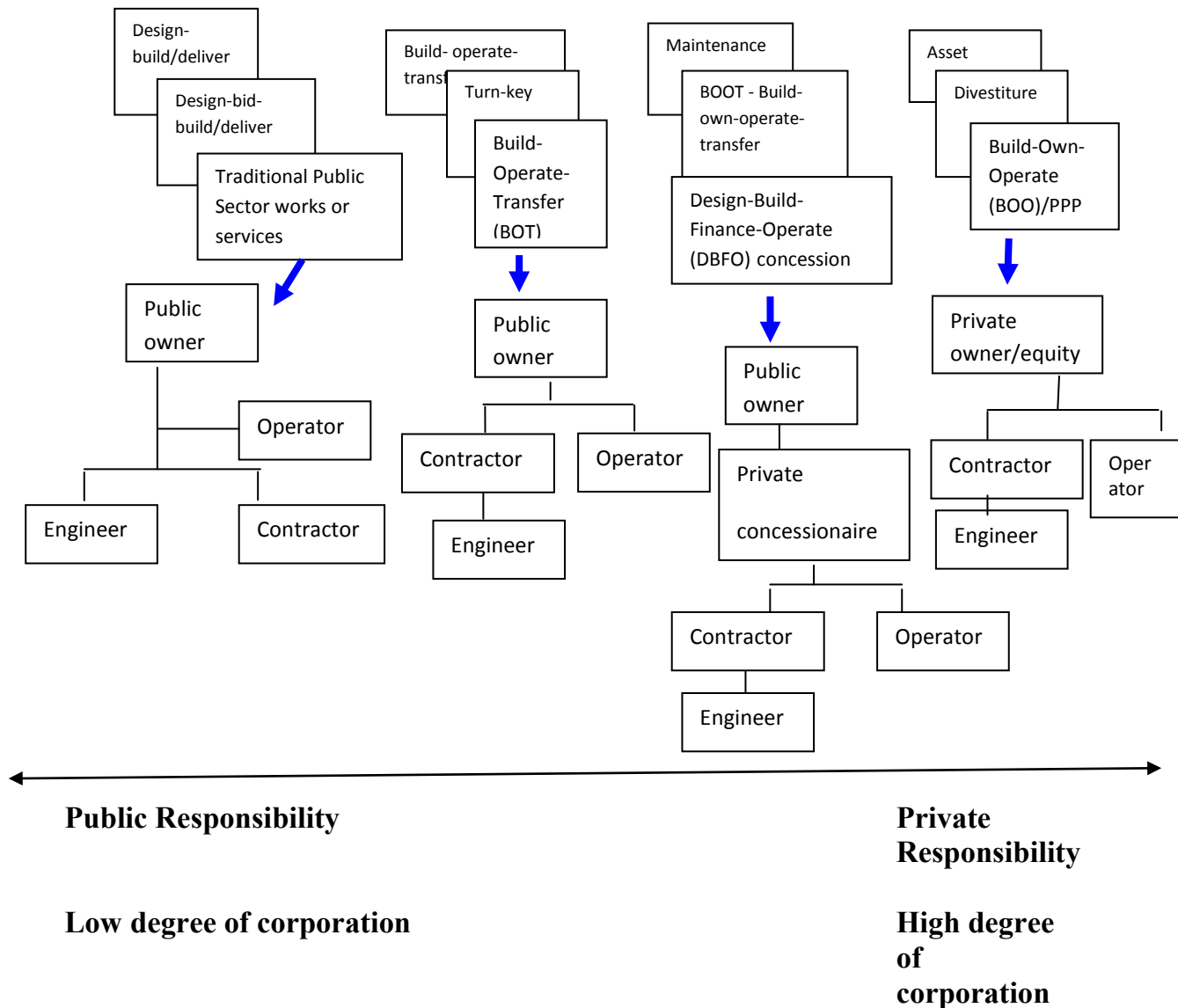
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<sup>44</sup> Commission (EC), 'Interpretative Communication on Concessions' (Communication) JOCE C/121, 29 April 2000.

<sup>45</sup> Commission (EC), 'Guidelines for Successful Public Private Partnerships' March 2003, p. 19.



## Different types of PPP<sup>46</sup>



<sup>46</sup> The figure draws inspiration from Commission (EC), 'Guidelines for Successful Public Private Partnerships' March 2003.

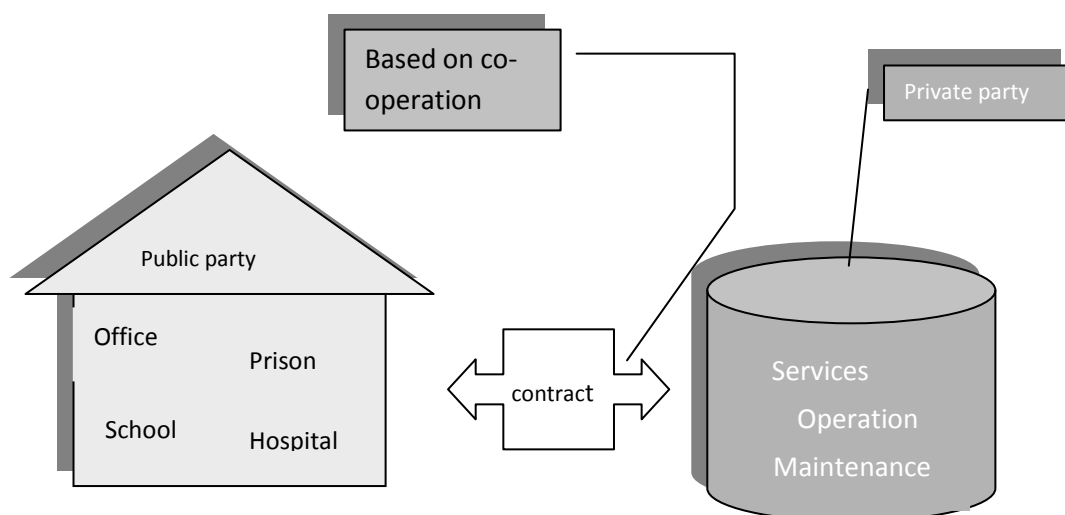
## 5.1 Traditional Works or service contracts

### 5.1.1 Service contracts

Public agencies can enter into service contracts with private sector companies for the completion of specific tasks. These tasks could include areas such as operation, installation, maintenance, delivering of food and services, or technical support. Service contracts are well-suited to operational requirements and may often focus on the procurement, operation and maintenance of new equipment. These types of service contracts are generally awarded by using public procurement regulation on a competitive basis, and extend from shorter periods of time, e.g. a few months, up to a few years.

Most of the public partnership arrangements are made on a purely contractual basis, which means that there is no company set up between the public and private party.

Instead of a building project, a public partnership in this type of contract concerns the delivery of a service, such as cleaning a school or a hospital, delivering food, or operating and maintaining public buildings.



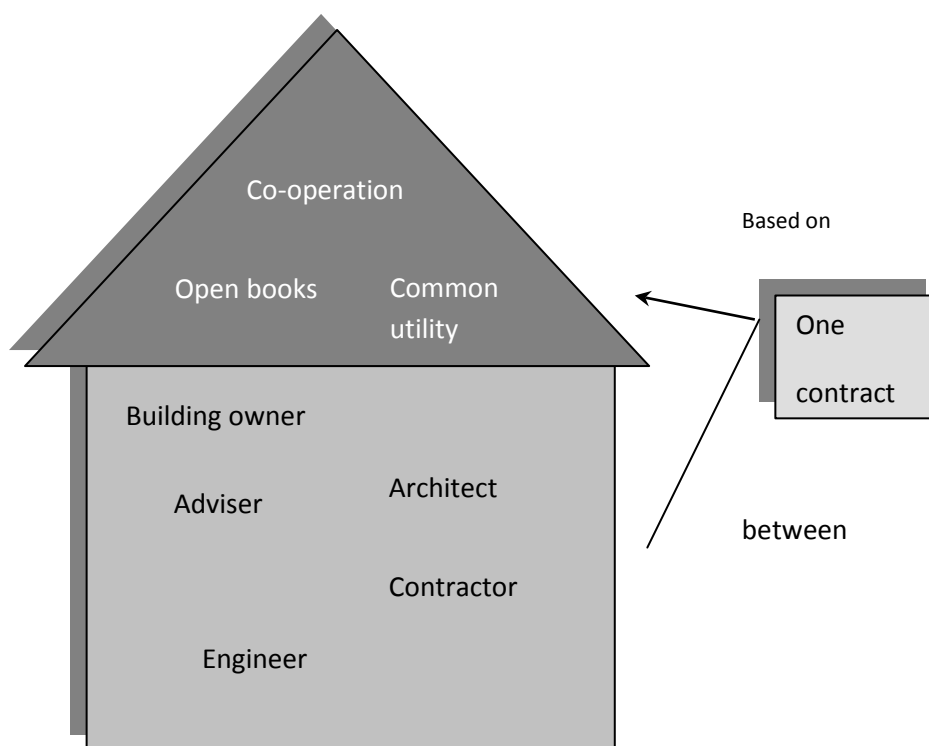
Source: C. Tvarnø<sup>47</sup>

<sup>47</sup> C. D. Tvarnø, 'Public private partnership in the European Union', in R. Nielsen and S. Treumer (eds.), *The New EU Public Procurement Directives* (Copenhagen: Djøf, 2005) pp. 183-194.

The service contract between the public party and the private party is based on a high degree of co-operation.<sup>48</sup> The public party benefits from the particular expertise of the private sector in managing staffing issues and achieving potential cost savings, but all management and investment responsibility remains with the public sector.

### 5.1.2 Works contract

A works contract builds on the framework of PPP, and therefore the co-operation is different from a traditional work contract. Normally, in a traditional work contract there are four or five contracts between the building owner, the adviser, the building contractor, the architect and the engineer and other suppliers.



<sup>48</sup> C. D. Tvarnø, *Partnering mellem offentlige myndigheder og private virksomheder* (Copenhagen: Julebog, 2003), p. 249.

Source: C. Tvarnø<sup>49</sup>

In a partnering arrangement there is only one contract between the mentioned parties as shown in the figure above. All five or more parties are involved in the tender. By co-operating, they all contribute to finding the best and cheapest solution and they share the responsibility for the performance.

The performance is based on the needs instead of the demands from the building owner, and therefore the partnering contract does not state exactly what the parties should perform, but instead how they will do it.

## **5.2 BOT (build-operate-transfer)**

In a build-operate-transfer project (BOT), the contractual functions of the parties remain the same as in the building contract, but more responsibilities are passed on to the private party. In the BOT the partnership is more integrated in that it involves transferring responsibility for the design, construction, and operation of a single facility or group of assets to the private sector partner.

The BOT concept combines responsibility for usually disparate functions – design, construction, and maintenance – under one single entity, which increases the efficiency. The project design can be tailored to the construction equipment and materials that will be used.

Compared to a more traditional public contract under public procurement law, the contractor in a BOT is required to establish a long-term maintenance program up front, together with estimates of the associated costs. The idea is to benefit from the fact that the contractor's detailed knowledge of the project design and the materials utilised can result in the development of a tailored maintenance plan over the project life that anticipates and addresses needs as they occur, thereby reducing the risk that issues will go unnoticed or unattended and then deteriorate into much more costly problems.

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<sup>49</sup> C. D. Tvarnø, 'Public private partnership in the European Union', in R. Nielsen and S. Treumer (eds.), *The New EU Public Procurement Directives* (Copenhagen: Djøf, 2005), pp. 183-194.

### **5.2.1 The service-works-BOT contract**

In both the service and the works contracts based on the PPP principles, the public party co-operates with the private party in order to share some of the responsibility for the service or operation with the private sector. The service providers or contractors can be paid on an incentive basis where they receive premiums for meeting specified service levels or performance targets.

The service-works-BOT contract has a more broad-reaching scope involving the management of a series of facilities by the private sector, and, therefore, it must create a good opportunity in order to encourage both the public and the private sector's involvement in the future.

### **5.3 DBFO concession**

The DBFO (design-build-finance-operate) arrangement is based on the concession idea. A concession is rooted in the idea that the end price is paid by the users and that the level of financial support required from the government and other grantors depends on the concessionaire's ability to implement the project.

A concession agreement enables a private investment partner to finance, construct and operate a revenue-generating infrastructure improvement in exchange for the right to collect the associated revenues for a specified period of time. Concessions often extend for a period of 25 to 30 years, or even longer, and are normally awarded under the public procurement law and competitive bidding conditions. Traditionally, concessions are not directly defined under the scope of PPP and are, therefore, not covered by the scope of this text book.

### **5.4 BOO (Building-Own-Operate)**

The BOO (Building-Own-Operate) concept is the most used in a PPP context. The performance in a BOO/PPP is focused on advice, design and architecture, works and construction, services, operation and maintenance. The duration of a BOO/PPP is normally 25-30 years, and the investments rest with the private party.

The BOO/PPP is a combination of the often used works contract (as described above) and the service contract. In most countries the use of PPP works and service contracts is widespread, and has been yielding good results. Both partnering building agreements and service partnership agreements are set up on the grounds that all investments are made by the public party, who pays the private party to build or supply.

The BOO/PPP relationship is a combination between a works and a service agreement, combined with private financing and private ownership. In a BOO/PPP arrangement, the private party has all the investments in the building and the service.

The contract and agreement between the parties are based on the premise that the parties optimise the joint utility of the transaction and not their own utility, and share all information by open books and calculations. The relationship is built on co-operation, trust and demands, facilitating the creation of the best and most efficient product. The parties still share the responsibility and cost of failures.

#### **5.4.1 The BOO/PPP contract**

The basis of the BOO/PPP agreement is co-operation, which affects the content of the contract. In a BOO/PPP contract the parties are bound by the following obligations<sup>50</sup>:

- The parties optimise the transaction, which means they optimise joint utility and not their own utility.
- The parties share all information. They have open books and calculations.
- The relationship is built on co-operation and trust.
- The Parties do not know the final product at the beginning. Instead the public party's needs are the focus.
- The process is more important than the end product because the process facilitates the creation of the best and most efficient product.
- The parties share the responsibility and cost of failures.

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<sup>50</sup> C. D. Tvarnø, 'Nogle særlige karakteristika ved partnering aftaler i byggebranchen' (2003) 45 UFR 366; and C. D. Tvarnø, *Partnering - En aftaleretlig udfordring* (Copenhagen: RETTID, 2002), p. 74.

## 5.5 Definition of Institutional Public Private Partnerships - IPPP

Pursuant to EC law, an IPPP is either a jointly held legal entity created by a public authority and a private party with the task of ensuring the delivery of a work of service for the benefit of the public, or an IPPP is being set up in situations where a private party takes control of some part of an existing public undertaking.<sup>51</sup>

In both situations, the private party will own a part of the stocks and control in the legal entity.<sup>52</sup> Apart from the equity, both the public and the private party participate actively in the operation of the contracts awarded to the public-private entity and in the management of the joint company.

The Commission explained that an IPPP ‘involves the establishment of an entity held jointly by the public partner and the private partner’.<sup>53</sup> By changing the investment structure in relation to a work or service, the Government can offer a work or service that would perhaps not otherwise be offered to the citizens. At the same time, an IPPP can ensure more efficient services and infrastructure projects based on the public needs, public and private funding, risk, know-how, and an efficient change in both parties’ incentives.<sup>54</sup>

The EC rules apply when private partners are chosen for IPPP. According to the Commission, whether the Public Procurement Directives or the general EC Treaty principles apply to the selection procedure of the private partner depends on the nature of the task

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<sup>51</sup> In Commission (EC), ‘Interpretative Communication on the Application of Community Law on Public Procurement and Concessions to Institutionalised Public-Private Partnerships (PPP)’ (Communication) C (2007) 6661, 5<sup>th</sup> February 2008, it states that the Commission understands an IPPP as ‘a co-operation between public and private parties involving the establishment of a mixed capital entity which performs public contracts or concessions.’ Thus, an IPPP can be set up in relation to a public task, either by creating a jointly held entity or in situations where the private party takes control of an existing public undertaking.

<sup>52</sup> An IPPP can also be described as a joint venture company, as defined in S. Arrowsmith, ‘Public Private Partnerships and the European Procurement Rules: EU Policies in Conflict?’ (2000) 37 *Common Market Law Review* 709-737, p. 720.

<sup>53</sup> Commission (EC), ‘Green Paper on public-private partnerships and Community Law on Public Contracts and Concessions’ (Green Paper), COM (2004) 327 final, 30<sup>th</sup> April 2004.

<sup>54</sup> Considering the positive effects from setting up an IPPP, it is remarkable that the number of IPPPs is very low in some Member States.

(public contract or concession) to be attributed to the IPPP.<sup>55</sup> If the task falls within the material scope of the Procurement Directives, the public authorities must comply with the EC procurement rules when setting up and contracting with an IPPP.

The EC procurement rules and principles cannot be avoided by claiming that the IPPP task is in-house. When the public authority holds part of the IPPP capital and one or more private parties also holds parts of the IPPP capital, the IPPP is defined as a company legally distinct from the public authority. In the *Stadt Halle* case,<sup>56</sup> the ECJ concluded that the Directive must always be applied when a contracting authority intends to conclude a contract (relating to services within the material scope of procurement Directive)<sup>57</sup> with a company legally distinct from it, in which the public authority holds capital together with one or more private undertakings.<sup>58</sup>

The ECJ is thus clearly stating that private capital investment in an undertaking follows considerations proper to private interests and

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<sup>55</sup> Thus, Community law is neutral as regards whether public authorities choose to provide an economic activity themselves or to entrust it to a third party. See also Commission (EC), ‘Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, on Public-Private Partnerships and Community Law on Public Procurement and Concessions’ (Communication) COM (2005) 569, 15<sup>th</sup> November 2005, section 1.

<sup>56</sup> Case C-26/03 *Stadt Halle and RPL Lochau* [2005] E.C.R. I-00001. In the *Stadt Halle* case the ECJ concluded, in regard to the in-house situation, that the Directive must always be applied when a contracting authority intends to conclude a contract for pecuniary interest relating to services within the material scope of the procurement Directive (the ECJ referred to the Council Directive (EC) 92/50 relating to the co-ordination of procedures for the award of public service contracts [1992] OJ L209/1 in the *Stadt Halle* case, but this also applies for the Council Directive (EC) 2004/18 on the co-ordination of procedures for the award of public works contracts, public supply contracts and public service contracts [2004] OJ L134/114 with a joint company, as e.g. an IPPP. This means that the IPPP can only be awarded a public contract if the joint company wins the contract in a competition under the procurement rules. See also S. Arrowsmith, *The Law of Public and Utilities Procurement* (2<sup>nd</sup> ed., London: Sweet & Maxwell, 2005), p. 392.

<sup>57</sup> The ECJ referred to the Council Directive (EC) 92/50 relating to the co-ordination of procedures for the award of public service contracts [1992] OJ L209/1 but this must still be the case concerning Council Directive (EC) 2004/18 on the co-ordination of procedures for the award of public works contracts, public supply contracts and public service contracts [2004] OJ L134/114.

<sup>58</sup> This means that in this situation the public award procedures laid down by the Directive must always be applied; see the *Stadt Halle* case, Paragraph 52.



pursues objectives of a different kind than considerations and requirements proper to the pursuit of objectives in the public interest.<sup>59</sup> If the award of a public contract to a semi-public company takes place without calling for tenders, this will, according to the ECJ, interfere with the objective of free and undistorted competition and the principle of equal treatment.<sup>60</sup> If the task is covered by the procurement Directives and the IPPP is not procured in the correct legal way, the IPPP would have an advantage over its competitors, which would interfere with the objective of free and undistorted competition and the principle of equal treatment.<sup>61</sup>

The Commission has published an interpretative communication<sup>62</sup> that, according to the Commission, will clarify ‘the rule of the game’. The Commission concludes that the aim of the interpretative communication is to enhance legal certainty and alleviate the concerns that procurement rules and EC law in general would make IPPPs unattractive or impossible to carry out.<sup>63</sup>

The question is whether this is the best solution, and whether this approach will succeed. The reasons for publishing the IPPP interpretation communication C (2007) 6661 were the perceived lack of legal certainty in the Member States in relation to the involvement

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<sup>59</sup> *Stadt Halle*, Paragraph 50.

<sup>60</sup> *Stadt Halle*, Paragraph 51.

<sup>61</sup> The only exemption to the main in-house rule in the *Stadt Halle* case is, according to the ECJ, if the public authority can perform the tasks conferred on it in the public interest by using its own administrative, technical and other resources without being obliged to call on outside entities. In an IPPP this situation will never be relevant, since the public authority will always call upon external entities, as this is the aim and purpose of setting up the IPPP. Thus, it follows from Paragraph 49 in the *Stadt Halle* case that, if the public authority itself performed the tasks in the public interest for which it is responsible by its own means, without calling upon external entities, the EC rules do not apply. The ECJ referred to, Case C-458/03 *Parking Brixen* [2005] E.C.R. I-8585, Paragraph 61, second part.

<sup>62</sup> Commission (EC), ‘The Commission Interpretative Communication on the Application of Community Law on Public Procurement and Concessions to Institutionalised Public Private Partnerships (IPPPs)’ (Communication), C (2007) 6661, 5<sup>th</sup> February 2008.

<sup>63</sup> R. William, ‘The Commission Interpretative Communication on the Application of Community Law on Public Procurement and Concessions to Institutionalised Public Private Partnerships (IPPPs)’ (2008) 17 (4) *Public Procurement Law Review* NA116.

of private partners and the risk that the IPPP's would not comply with EC Law.<sup>64</sup>

According to C (2007) 6661, the Commission does not consider a double tendering procedure to be practical. The Commission interprets the EC law in such a way that one tendering procedure suffices, and the procedure applies when selecting the private partner in an IPPP set-up.<sup>65</sup> Either the Public Procurement Directives or the general EC Treaty principles apply to the selection procedure of the private partner in the IPPP. Hence, the IPPP must be set up by a fair and transparent procedure.

In C (2007) 6661, the Commission recommends that the invitation to tender includes information on the public contracts to be awarded to the future public-private entity; the statutes of association; the shareholder agreement; all elements governing the contractual relationship between the contracting entity and the private partner; and all future adjustments concerning the task.

Thus, when setting up an IPPP, it is not necessary to make one procedure for selecting the private partner to the IPPP and another tendering procedure for awarding public contracts to the IPPP after the establishment of the IPPP.<sup>66</sup>

The lack of a legal definition of the IPPP is a problem because EC law does not consider co-operation to be the key element in a successful IPPP. Both parties must have influence on the IPPP project.

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<sup>64</sup> This legal uncertainty and risk can discourage both public authorities and private parties from entering into an IPPP at all. This risk constitutes a problem since public authorities at all levels are interested in types of co-operations with the private sector, and this interest is increasing in the Member States. The interest in constructing IPPPs is increasing because of national needs for ensuring infrastructure and services; see Commission (EC), 'Public Procurement: Commission issues guidance on setting up Institutionalised Public-Private Partnerships – Frequently Asked Questions' (Memo) MEMO/08/95, 18<sup>th</sup> February 2008. The IPPP interpretation communication therefore sets out, as a legal guidance to the Member States, the Commission's understanding of how the Community provisions on most types of public procurement and concessions are to be applied to the funding and operation an IPPP. The interpretation communication does not create new rules concerning IPPPs; rather, it reflects the Commission's understanding of the rules in the procurement Directive and the EC treaty, and the relevant case law by the ECJ.

<sup>65</sup> See Commission (EC), 'Public Procurement: Commission issues guidance on setting up Institutionalised Public-Private Partnerships – Frequently Asked Questions' (Memo) MEMO/08/95, 18<sup>th</sup> February 2008.

<sup>66</sup> The Commission concludes in C (2007) 6661 that simple capital injections made by private investors into publicly owned companies do not constitute an IPPP.

However, the public procurement rules prescribe that the public party in the tender procedure sets out all of the conditions and that only minor matters can be changed after the award; otherwise, a new procedure must be set up. These rules do not support the key element of co-operation. The Commission does not take into consideration that both PPPs and IPPPs have very specific characteristics with regards to co-operation and output which are not reflected in the EC public procurement rules.

The lack of acknowledgement of the co-operation and the need for negotiation between the parties is troublesome. The main priority of the present legislation is equal treatment, transparency and free movement, which are all fundamental principles in the European Union. However, the citizens, the private parties, and the public authorities must also be allowed to achieve the most efficient agreement and outcome when undertaking an IPPP.

The lack of legal definition and the ban on negotiation are analysed and commented in chapter 6.

## **6. The economics behind PPP**

A partnership can function only where organising the project between partners leads to a greater economic benefit than there would be otherwise.

One significant objective of a PPP contract is to ensure the common utility by co-operation, open books, trust, negotiation, focusing on needs instead of demands, and the sharing of responsibility. As stated by McQuaid:

The main assumption for using partnerships is that partners are not in a zero (or rather constant) sum game. By co-operating the total output is increased for a given level of resources.<sup>67</sup>

If the parties are not allowed to negotiate and co-operate with each other, it is not possible to achieve the common utility: a better and cheaper product. This discussion is elaborated in chapter 6 below.

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<sup>67</sup> See also R. W. McQuaid, 'The theory of partnerships: why have partnership?', in S. P. Osborne (ed), *Public-Private Partnerships: Theory and Practice in International Perspective* (London: Routledge, 2000), p. 19.

The partnership can increase both joint and individual efficiency through improved co-ordination.<sup>68</sup>

The objectives of the partnership are to:

- Reduce the cost and price
- Increase the quality
- Reduce the risk
- Reduce the failures
- Improve the co-ordination
- Share capacity between the parties

These factors may in the end reduce tax rates. By gaining these advantages the parties are allowing each partner to gain from the partnership, while still retaining party autonomy. These are important issues when public authorities in an urban economic development are aiming to create wealth, sustainability, social security and employment.<sup>69</sup> The results of partnering have been too good for governments to ignore.

## **7. PPP in a public procurement law reality**

Public contracts, such as partnering contracts and PPP contracts, will normally fall under the scope of public procurement law. Neither national legislation<sup>70</sup> nor the EU has legal rules that specifically cover the PPP arrangement in regard to public contract rules. The EU public procurement law is based on the common market and the elimination

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<sup>68</sup> R McQuaid, 'The theory of partnerships: why have partnership?', in S. P. Osborne (ed), *Public-Private Partnerships: Theory and Practice in International Perspective* (London: Routledge, 2000), p. 21.

<sup>69</sup> See also R. McQuaid, 'The theory of partnerships: why have partnership?', in S. P. Osborne (ed), *Public-Private Partnerships: Theory and Practice in International Perspective* (London: Routledge, 2000), p. 25.

<sup>70</sup> A few countries have enacted specific national rules covering PPP: Brazil enacted a PPP act in December 2004, designed to encourage investments for crucially needed infrastructure projects. See Law No. 11.078, D.O.U.31 Dec., 2004 and also C.V. Filho and J.B.Lee, 'Brazil's New Public-Private Partnership Law: One Step forward, Two Step Back'(2005) 22(5) *Journal of International Arbitration* 419-426.

of barriers to trade in goods between Member States and barriers to movement in business, labour and capital.<sup>71</sup>

The political and economic reasoning behind the common market is grounded in the economic theory of comparative advantages.<sup>72</sup> The purpose of the public procurement law is to ensure an opening up of the public procurement market.<sup>73</sup> The public procurement Directives set out the legal framework for public procurement. The legislation, directives and model laws apply when public authorities and utilities seek to acquire goods, services, civil engineering or building works. The importance of these in relation to PPP is that the principles in the public procurement law set out rules and procedures which must be followed before awarding a PPP contract.

The public procurement law has several objectives, such as the elimination of corruption and the increased effectiveness of good public services and government. The procurement rules ensure that the government applies the highest professional standards when it spends money on behalf of taxpayers.

Competition is one cornerstone of public sector procurement. Maintaining market interest or the creation of a market are also significant elements in public procurement regulation. In markets with no or limited competition, the procurement rules can undertake market soundings. Other objectives of the public procurement law are: to ensure fairness and equal treatment; to improve procurement practices; to open up the competition; and to lower the overall prices. The basic principles to obtaining these goals are transparency, non-discrimination, equal treatment, proportionality and competition. All these objectives will be discussed and analysed later on in the book.

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<sup>71</sup> Thus, a public contract depends on the respect of the procurement rules, the respect of the fundamental principle of competition concerning equal access to the market, the ban on anti-competitive agreements, and economic and financial equilibrium of the projects.

<sup>72</sup> See P. Krugmann and M. Obstfeld, *International Economics, Theory and Policy* (6<sup>th</sup> ed., London: Addison-Wesley, 2003), part I.

<sup>73</sup> S. Arrowsmith, *The Law of Public and Utilities Procurement*, (2<sup>nd</sup> ed., London: Sweet & Maxwell, 2005), p. 121; C. H. Bovis, *EU Public Procurement Law* (Cheltenham: Elgar European Law, 2007), p. 52 and M. Burnett, *Public-Private-Partnerships (PPP) – A Decision Maker's Guide* (Maastricht: Institut Européen d'Administration Publique, 2007).

## **Part II**

### **Legal analysis**

## Chapter 3

### PPP and WTO Procurement Law

#### 1. Introduction

The World Trade Organisation (WTO) aims at facilitating the global trade flow of goods and services. Today, the term ‘globalisation’ has become a popular means of describing different global exchanges, including economic exchanges.<sup>74</sup> In a WTO context, ‘economic globalisation’ has been defined as the process of integrating the global trade of goods and services, and the opening up of borders for foreign direct investment.<sup>75</sup> Globalisation has a clear impact on PPP; a private enterprise might be interested in engaging in a partnership with a public entity from a foreign state, or a state might be interested in attracting foreign investment through a PPP.

This chapter concerns the WTO government procurement rules. As was described in chapter 2, government procurement law is relevant to PPPs in order to ensure transparency, non-discrimination and competition in the market. It is necessary to ensure these principles internationally through international rules dealing with PPP and government procurement. For example, the complex character of a PPP opens the possibility for potential private suppliers to bribe the governmental institutions in developing countries.<sup>76</sup> The WTO rules concern international trade between states, and the WTO procurement rules facilitate the access of a supplier to the procurement in a foreign

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<sup>74</sup> See more about the concept of ‘globalisation’ and global regulation in L. Boulle, *The Law of Globalization: An Introduction* (Alphen aan den Rijn: Kluwer Law International, 2009).

<sup>75</sup> See World Trade Organisation, *World Trade Report 2008: Trade in a Globalising World*, p. 15.

<sup>76</sup> OECD. ‘Ensuring the Efficient Use of Public-Private Partnerships in MENA Countries’ (2010) 8 *OECD Governance* 210-233, at p. 218.

State, but at the same time they ensure the transparency in the procurement process to eliminate corruption.

The WTO rules only apply in cross-border transactions – not in intra-domestic situations. They also only apply to situations where a WTO Member is imposing trade obstacles to the importation of goods or services from another WTO Member. For example, if a public entity in the EU wants to enter into a PPP arrangement, the WTO rules on government procurement provide that a bidder in, for example, Singapore shall be treated in a non-discriminatory manner. The WTO rules will not apply to internal situations. For example, if the government in Singapore imposes some restrictions on its internal production with no effect on the importation of like products, then the WTO rules will not apply.

Compared to the general WTO framework with its 153 Members, the WTO government procurement rules have a lower number of state parties. Furthermore, the parties to the WTO government procurement rules have made different commitments. For example, the different parties have different commitments in relation to which services or products are covered by the WTO procurement rules. The central WTO agreement on government procurement is the Agreement on Government Procurement (GPA). The GPA is the main focus in this analysis of WTO procurement law and PPPs.

In order to get a full picture and understanding of the GPA, an analysis of the GPA must include a general WTO context as well as a public international law context. The GPA is under the WTO framework, which includes the general WTO principles and the WTO Dispute Settlement System. However, the WTO cannot be examined in isolation from public international law. The WTO agreements, including the GPA, must be interpreted in accordance with the customary rules of interpretation of public international law; public international law fills in the gaps where the WTO agreements are silent.<sup>77</sup>

The question is whether the GPA in its present form is sufficient to cope with PPPs. One major challenge is the lack of signatories, in particular from developing and least-developed countries, to the GPA.

This chapter is divided into 2 parts. Part 1.2 concerns WTO as a legal system. The WTO is largely based on treaties between nations and must be seen in the context of public international law. Part 1.3 focuses on the GPA.

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<sup>77</sup> See more in section 2.2.



## 2. WTO Law and PPP

### 2.1 PPP and the WTO Members

Several WTO Members use PPPs in projects concerning infrastructure, communication, etc. For example, in Bangladesh, private parties are encouraged to invest in public infrastructural projects.<sup>78</sup> Indonesia carries out a PPP project concerning the supply of drinking water.<sup>79</sup> Macao uses PPPs in the energy sector.<sup>80</sup> In Mongolia, the Government has facilitated the development of information and communications infrastructure by entering into PPP arrangements.<sup>81</sup> The Myanmar Ministry of Hotels and Tourism has enhanced the use of PPPs concerning marketing activities for tourism in Myanmar.<sup>82</sup> The Philippines has enacted the Build-Operate-Transfer Law to attract private investments in the development of infrastructure.<sup>83</sup> The Eastern African Submarine Cable System (EASSy) aims at connecting 21 African countries by establishing

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<sup>78</sup> Government of the People's Republic of Bangladesh Ministry of Finance, 'Country Paper on Infrastructure Development with Focus on Public-private partnerships' (2007), p. 9, at: <[http://www.unescap.org/ttdw/ppp/reports/Bangladesh\\_10July2007.pdf](http://www.unescap.org/ttdw/ppp/reports/Bangladesh_10July2007.pdf)> accessed 30 November 2010.

<sup>79</sup> Indonesia, 'Country Paper on Public-private partnerships for Infrastructure Development in Indonesia' (2007), p. 17, at: <[http://www.unescap.org/ttdw/ppp/reports/Indonesia\\_2July2007.pdf](http://www.unescap.org/ttdw/ppp/reports/Indonesia_2July2007.pdf)> accessed 30 November 2010.

<sup>80</sup> Macao, Special Administrative Region, China, 'Country Report on Infrastructure, Macao, China' (2007) at: <[http://www.unescap.org/ttdw/ppp/reports/Macao\\_31May2007.pdf](http://www.unescap.org/ttdw/ppp/reports/Macao_31May2007.pdf)> accessed 30 November 2010.

<sup>81</sup> ICT Authority of Mongolia, 'Information and Communication Technology Sector Development in Mongolia' (2007), pp. 4-5, at: <<http://www.unescap.org/ttdw/ppp/countryreports.html>> accessed 30 November 2010.

<sup>82</sup> Myanmar, 'Country Report on Infrastructure Development with Focus on Public-Private Partnerships (PPP)' (2007), p. 38, at: <[http://www.unescap.org/ttdw/ppp/reports/Myanmar\\_6july2007.pdf](http://www.unescap.org/ttdw/ppp/reports/Myanmar_6july2007.pdf)> accessed 30 November 2010.

<sup>83</sup> Philippines, 'Philippine Country Report on Infrastructure' (2006), pp. 5-6, at: <[http://www.unescap.org/ttdw/ppp/reports/Philippines\\_4Jan2006.pdf](http://www.unescap.org/ttdw/ppp/reports/Philippines_4Jan2006.pdf)> accessed 30 November 2010.

partnerships between governmental entities and private investors.<sup>84</sup> MSC Malaysia has an e-Government program which depends on private investments in PPP.<sup>85</sup> In Kenya, AIDS information is provided by mobile phone by interactive voice response, WAP and SMS technology from a PPP.<sup>86</sup> The PPP model is also used widely within the EU Member States<sup>87</sup> and in the US.<sup>88</sup>

International organisations work to propagate the PPP instrument as a means of enhancing improvements in infrastructure. In particular, these organisations suggest that developing and least-developed countries use the PPP model as a means to overcome infrastructural problems. The United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) addressed PPPs at the ‘High-level Expert Group Meeting on PPPs for Infrastructure Development’ in 2007.<sup>89</sup> The World Bank Institute, which is the World Bank’s principal provider of learning services, focuses specifically on PPPs as important tools to deliver essential public services such as infrastructure, health and education.<sup>90</sup>

In the WTO, different committees recommend States to enhance the use of PPPs. For example, in the field of capacity building for food standards, the Committee on Sanitary and Phytosanitary Measures under the WTO has improved the collaboration with the Food and

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<sup>84</sup> ICT Regulation Toolkit, Practice Note: Public-Private Partnerships in the telecommunications and ICT sector, at: <<http://www.ictregulationtoolkit.org/en/PracticeNotes.html>> accessed 30 November 2010.

<sup>85</sup> *ibid.*

<sup>86</sup> Danida, ‘PPP, Partnership With a Purpose, Corporate Social Responsibility: Support Facilities in the Public Private Partnership Programme’ (2006), p. 8, at: <<http://amg.um.dk/nr/rdonlyres/7c67fb92-9f8f-476b-8867-a5216e6434a1/0/publicprivatepartnershipprogramme.pdf>> accessed 30 November 2010.

<sup>87</sup> PPPs are, for example, used in the educational sector and in healthcare in the United Kingdom; see N. Maltby, ‘Current Developments in the United Kingdom’ (2010) 5 (2) *European Public Private Partnership Review* 120-123. In Portugal, PPPs have been used in the road sector; see D. Duarte de Campos, ‘Changes in the Road Sector’ (2010) 5 (2) *European Public Private Partnership Review* 119-120.

<sup>88</sup> See, for example, Oregon Telecommunications Coordinating Council, ‘Public-Private Partnerships for Telecommunication in Oregon’ (2003), pp. 7-10, at: <<http://www.ortcc.org/PDF/PPPpartnerships.pdf>> accessed 30 November 2010.

<sup>89</sup> See: <[http://www.unescap.org/ttdw/common/TPT/ppp/egm\\_ppp\\_oct07.asp](http://www.unescap.org/ttdw/common/TPT/ppp/egm_ppp_oct07.asp)> accessed 30 November 2010.

<sup>90</sup> See: <<http://wbi.worldbank.org/wbi/about/topics/public-private-partnerships>> accessed 30 November 2010.

Agriculture Organisation of the United Nations (FAO) and World Health Organisation (WHO). Together with the World Organisation for Animal Health (OIE) and Industry Council for Development (ICD), the latter organisations are reviewing the means of increasing the use of PPP in order to enhance the capacity building for food and water supply for the global needs.<sup>91</sup>

Even though the PPPs have become an internationally recognised concept and are applied on a global scale, there is no clear international agreement or provision in the GPA specifically dealing with PPPs and government procurement. PPPs are often of a complex nature, both in terms of their intended output, and their institutional aspects. This complexity has led the EU to introduce more flexible rules for competitive dialogue between the public entity and the potential suppliers in order to define the actual intended output based on the needs of the public entity.<sup>92</sup> The United Nations Economic Commission for Europe questions whether the traditional rules on government procurement suffice to cover the complexities of establishing PPPs.<sup>93</sup> In particular, the lack of flexibility in government procurement law might be an obstacle to fruitful co-operation between public entities and private parties. However, they must also aim to avoid abuse and corruption, which may result from rules which are too flexible.

## 2.2 The WTO and Its Legal Character

The WTO is concerned with international trade in goods and services. There are 153 Members of the WTO, and 30 states currently hold an

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<sup>91</sup> Committee on Sanitary and Phytosanitary Measures, 'Capacity Building for Food Standards and Regulations' (16 June 2009) G/SPS/GEN/938, section III.

<sup>92</sup> Directive (EC) 2004/18 of the European Parliament and of the Council of 31 March 2004 on the Co-ordination of Procedures for the Award of Public Contracts, Public Supply Contracts, and of Public Service Contracts [2004] OJ L 134/114, Article 29. See also Commission (EC), 'Green Paper on public-private partnerships and Community law on public contracts and concessions' (Green Paper) COM (2004) 327 final, 30 April 2004,.

<sup>93</sup> United Nations Economic Commission for Europe, *Guidebook on Promoting Good Governance in Public-Private Partnerships* (Geneva: United Nations, 2008), pp. 4-5.

observer status in the WTO. Also, several organisations are granted observer status in the WTO. The WTO has two important functions:<sup>94</sup>

1. The WTO is an international forum for its 153 members to negotiate trade rules and to address the different challenges that follow from increased globalisation. The increase of, and demand for, global transactions of goods and services requires a decrease in national and regional trade barriers.

2. The WTO monitors the different WTO trade agreements and provides enforcement mechanisms if a WTO member violates another member's right under the trade rules. The WTO provides different legal means to ensure the reduction of trade barriers.

The legal character of the WTO system is reflected in both the trade agreements, the institutions to monitor and supervise the WTO members, and the Dispute Settlement Body to settle disputes between WTO Members. The WTO, as a legal system based on trade agreements and with the Dispute Settlement Body, is part of public international law. Public international law is a system of rules with the states as the primary subjects and primary actors in the creation of law.<sup>95</sup> The creation of public international law is primarily decentralised, in contrast to national law, where there is a central body to create law.<sup>96</sup> The GPA must be seen in that light. The GPA is an international agreement based on states' consent, but the GPA cannot be seen in isolation from public international law.<sup>97</sup> Public international law will fill any gaps in the GPA and can serve as context in the interpretation of the GPA.

PPPs are a direct effect of globalisation with its need for free trade between states;<sup>98</sup> therefore, the WTO trade rules are an important legal

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<sup>94</sup> See Art. III of the WTO Agreement.

<sup>95</sup> It is a point of contention whether states can be bound by international rules of law to which they have not consented.

<sup>96</sup> See, for example, J. Pauwelyn, 'The Role of Public International Law in the WTO: How Far Can We Go?' (2001) 95 *American Journal of International Law* 535-578.

<sup>97</sup> See also I. Van Damme, *Treaty Interpretation by the WTO Appellate Body* (Oxford: Oxford University Press, 2009), pp. 358-359; and G. Marceau, 'Conflict of Norms and Conflict of Jurisdictions – The Relationship between the WTO Agreement and MEAs and other Treaties' (2001) 35 (6) *Journal of World Trade* 1081-1131.

<sup>98</sup> See also chapter 2 above and C. D. Tvarnø, 'Public private partnership in the European Union', in R. Nielsen and S. Treumer (eds.), *The New EU Public Procurement Directives* (Copenhagen: Djøf, 2005), pp. 183-194.

tool for ensuring that national and regional legislation on government procurement aids openness to foreign suppliers participating in PPPs. The public entity of states parties to the GPA must be familiar with the rules of the GPA.

Both Multi-National Enterprises and national enterprises must also be aware of WTO procurement law to monitor that their bidding on a PPP contract is treated in accordance with WTO law. Even though WTO law does not create direct rights for private parties in the WTO system - i.e. the Dispute Settlement System in the WTO applies only to States - a private party can either try its case at the domestic courts or through other national enforcement mechanisms in the country of the government procurement, or the private party can persuade its own government to file a complaint against the country which has violated WTO procurement law.

The following sections focus on the legal character of the WTO. The first section explains the aim of the WTO. The next section concerns WTO and government procurement law. The following section describes WTO as a rule-oriented system that is a legal system with some political aspects. Finally, the sources of law relevant to government procurement law of the WTO are described.

### **2.2.1 The Aim of the WTO**

It follows from the aim of the WTO Agreement that the parties are:

*Recognizing* that their relations in the field of trade and economic endeavour should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, and expanding the production of and trade in goods and services, while allowing for the optimal use of the world's resources in accordance with the objective of sustainable development, seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development,

*Recognizing* further that there is need for positive efforts designed to ensure that developing countries, and especially the least developed among them, secure a

share in the growth in international trade commensurate with the needs of their economic development.<sup>99</sup>

Hence, the WTO has two important purposes. First, the WTO aims at facilitating trade between its Members. This is reflected in the different WTO agreements, which aim at reducing trade barriers. Secondly, the WTO aims at securing for developing and least developed countries a share of international trade. For example, some of the WTO cornerstones, which are briefly touched upon below, have special exceptions for developing and least-developed countries.

The WTO provides a range of different Agreements in order to fulfil the aims of the WTO. Those different WTO agreements are all annexed to the overall WTO Agreement, the Marrakesh Agreement Establishing the WTO (the WTO Agreement). Most of the agreements under the WTO Agreement are multilateral, i.e. they are binding on all the WTO members. Here, the GPA is an exception. The GPA is plurilateral, i.e. it is not a general agreement but has a smaller number of signatories.

The different agreements in the WTO system can broadly be categorised into three areas concerning goods, services, and intellectual property rights. The different WTO agreements, including the GPA, have some common traits which reflect the general aims of the WTO (which are also the cornerstones of the WTO):

- Non-Discrimination: the WTO builds upon two important non-discrimination principles. 1) the Most-Favoured-Nation (MFN) principle, i.e. members must not discriminate between its trading partners; 2) the National Treatment principle, i.e. members must not discriminate between national and foreign goods, services and investments. The National treatment principle is directly written into the GPA. The MFN principle, although with some reservations and another label,<sup>100</sup> is also in the GPA. See more in section 1.3.2.1;
- Market access: through negotiation rounds, the general level of trade obstacles for goods and services has been decreased, for example by tariff reductions and by eliminating non-tariff barriers like rules on import licensing. The GPA is, by its very nature, promoting market access for foreign suppliers in

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<sup>99</sup> WTO Agreement, preamble.

<sup>100</sup> In the GPA, the MFN principle is categorised as ‘non-discrimination principle’.

government procurement and is opening up for foreign direct investment;

- Unfair trade: the WTO market access principle must be weighed against rules on fair competition. A WTO Member is allowed to impose country-specific duties and thereby exempt the MFN principle and the market access principle in situations where the imported products are being subsidised by the exporting country, or when the exporting producer is dumping the prices. The GPA also has written unfair trade rules into its purpose and text. For example, a public entity must not seek advice from a potential supplier/partner to a PPP if the competition would, through this, be precluded. See more in section 1.3.4.1.2;
- Special differential rules for developing and least-developed countries: The different WTO agreements allow developing and least-developed countries to make exceptions from the national treatment principle and the MFN principle in order to enhance the local production. The GPA also contains special and differential rules for developing and least-developed countries, although the GPA has not appealed to developing and least-developed countries yet. See more in section 1.3.2.3.

## **2.2.2 The WTO and Government Procurement Law**

The WTO has its roots in the General Agreement on Tariffs and Trade (GATT) from 1947.<sup>101</sup> GATT 1947 concerned only trade in goods, and government purchases were explicitly exempted from the agreement. As the years passed, some GATT Contracting Parties, mainly developed countries, wanted to regulate governmental purchases under the GATT multilateral framework. However, those countries did not succeed in persuading the other GATT Contracting

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<sup>101</sup> GATT was both the name of the agreement and the name of the organisation between 1948 and 1994, until the WTO came to life in 1995. Under the WTO umbrella, there is an agreement, GATT 1994, based on the GATT 1947. GATT 1994 consists of the provisions of GATT 1947. Therefore, when reference is made to GATT 1994, GATT 1947 must be consulted. For a thorough examination of the pre-GATT and GATT negotiations concerning government procurement and GATT, see: G. Marceau and A. Blank, 'History of the government procurement negotiations since 1945' (1996) *Public Procurement Law Review* 77-147.

Parties toward such an agreement. Instead, the GPA was created as a plurilateral agreement, only binding a few of the GATT Contracting Parties.

When the WTO was established in 1995, the GPA was amended, but it continued as a plurilateral agreement. The GPA has not appealed to several developing and least-developed countries, which are not under the obligations of the GPA concerning government procurement.<sup>102</sup> The scope of WTO law in relation to procedures for public entities' procurement when establishing PPPs are, therefore, more limited in comparison with the general trade facilitating rules in the multilateral agreements of GATT 1994, the successor to GATT 1947, and the General Agreement on Trade in Services (GATS).

Government procurements of goods are exempted from the National Treatment principle in the GATT 1994, Article III. 8(a). It is unclear and debated in literature whether government procurements are exempted from the MFN principle in Article I of the GATT 1994. Some, including many of the GPA members, argue that this principle does not apply to government procurement.<sup>103</sup> The alternative view is that the MFN principle does apply, since there is no explicit exception written into the GATT; based on a textual approach, this may indicate that the MFN principle in GATT applies to government procurement.<sup>104</sup>

In relation to services, government procurements are explicitly exempted from the MFN principle, the National Treatment principle and market access. However, GATS Article XIII.1 and GATS Article

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<sup>102</sup> See, for example, A. Kovacs, 'The Global Procurement Harmonisation Initiative' (2004) *Public Procurement Law Review* 15-38, at p. 18; V. Guimaraes De Lima e Silva, 'The revision of the WTO Agreement on Government Procurement: to what extent might it contribute to the expansion of current membership?' (2008) *Public Procurement Law Review* 61-98; V. Rege, 'Transparency in Government Procurement – Issues of Concern and Interest to Developing Countries' (2001) 35 (4) *Journal of World Trade* 489-515.

<sup>103</sup> S. Arrowsmith *Government Procurement in the WTO* (The Hague:Kluwer Law International, 2003), pp. 61-63. See M. Dischendorfer, 'The Existence and Development of Multilateral Rules on Government Procurement under the Framework of the WTO' (2000) *Public Procurement Law Review* 1-38, at 15-17.

<sup>104</sup> For this approach, see: A. Reich, 'The New GATT Agreement on Government Procurement – The Pitfalls of Pluralism and Strict Reciprocity' (1997) 31 *Journal of World Trade* 125-151, at pp. 142-145. For a discussion about the GATT negotiations, see: G. Marceu and A. Blank 'History of the government procurement negotiations since 1945' (1996) *Public Procurement Law Review* 77-147, at pp. 87-88 and footnote 19.



XIII.2 require the WTO Members to negotiate on preparation to include government procurement of services multilaterally under GATS.

Due to the plurilateral nature of the GPA, any amendments to it, decision-making, or interpretations of it are based on the special rules in the GPA, and not on the overall rules in the WTO Agreement.<sup>105</sup> However, in cases of dispute between GPA Parties, the WTO Dispute Settlement Body has the authority to settle the dispute.

Other international organisations provide different tools concerning government procurement. The United Nations Commission on International Trade Law (UNCITRAL) provides the UNCITRAL Model Law on Procurement of Goods, Construction and Services (1994). The UNCITRAL Model Law is applied by several countries as an inspiration to modulate their national laws on government procurement. The World Bank provides procurement guidelines addressing projects that are financed by the World Bank. Such projects may not be influenced by political or other non-economic considerations.<sup>106</sup> The result is the non-binding Procurement Guidelines of the World Bank.<sup>107</sup>

All of those tools have been addressed at the WTO working Group on Transparency in Government Procurement; the GPA, the UNCITRAL and the World Bank share the same common goal: to increase transparency in government procurement. It is important to note that unlike with the GPA, the guidelines by these other organisations are non-binding, and, if they conflict with the GPA, the GPA prevails.

On a regional level, there are both binding and non-binding rules on government procurement. The EU procurement rules are a clear example of rules which create rights and obligations between both the EU member states, and between private companies and the EU

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<sup>105</sup> WTO Agreement, Art. IX.5 and Art. X.10. It must further be assumed that in cases of conflict between the WTO Agreement and the GPA, the GPA will prevail due to the principle of *lex specialis*. This assumption is further strengthened by the fact that Art. XVI.3 of the WTO Agreement deals only with conflicts between the WTO Agreement and the *multilateral* Agreements, where the former will prevail.

<sup>106</sup> See Art. V.1(g) of the International Development Association (IDA) Articles of Agreement, and Art. III.5(b) of the International Bank for Reconstruction and Development (IBRD) Articles of Agreement. Both the IDA and the IBRD are institutions under the World Bank.

<sup>107</sup> See Art. I (1.1) of the Guidelines.

states.<sup>108</sup> The North American Free Trade Agreement (NAFTA) has specific

rules dealing with government procurement in the inter-state relationship between Canada, Mexico and the US.<sup>109</sup> The Common Market for Eastern and Southern Africa (COMESA) requires its members to increase the information flow between themselves concerning public procurement,<sup>110</sup> although the Agreement does not provide specific rules concerning such procurement procedures. El Mercado Común del Sur (Mercosur) in South America has worked out a Protocol on government procurement, which still needs implementation.<sup>111</sup>

### 2.2.3 Rule Orientation

In order to fully understand WTO procurement law, law must, as far as is possible, be distinguished from politics. One must find the line between international law as a normative system with binding force forming national and regional law to comply with WTO law on the one side, and international relations as reflecting actual state power where politics shapes law on the other.<sup>112</sup> In other words, an international law perspective on WTO procurement law will claim that the GPA has a binding character and that the GPA parties will follow the GPA guidelines, for example, if there is a well-functioning enforcement system.<sup>113</sup> An international relations perspective will instead focus on the political power between the GPA Parties.

As mentioned above, the WTO provides an international trade forum for negotiations, and the WTO monitors its Members'

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<sup>108</sup> See more in chapter 4 below.

<sup>109</sup> North American Free Trade Agreement, Chapter 10, Art. 1001-1007.

<sup>110</sup> Agreement Establishing COMESA, Art. 141.

<sup>111</sup> Protocolo de Contrataciones Públicas del Mercosur, Decisión No. 23/06, not currently in force.

<sup>112</sup> See for example A.M. Slaughter Burley, 'International Law and International Relations Theory' (1995) 87 *American Journal of International Law* 205-239, at 215.

<sup>113</sup> In WTO, *European Communities – Trade Description of Sardines – Report of the Appellate Body* (26 September 2002) WT/DS231/AB/R, para.278, the Appellate Body made the clear assumption that every WTO Member will abide by their treaty obligations in good faith, as required by the principle of *pacta sunt servanda* articulated in Article 26 of the Vienna Convention on the Law of Treaties.

compliance with the WTO agreements.<sup>114</sup> The WTO has no power to create law. The law creation is entirely left to the WTO Members. The WTO monitoring of member's compliance also depends on the WTO members providing the necessary information to the WTO; the WTO does not provide a government to enforce the WTO agreements. Furthermore, the WTO itself cannot sanction a WTO Member. Such sanctions depend on its members' willingness to carry them out. WTO law cannot be seen outside of its political context, but, at the same time, the WTO reflects the request for a more rule-oriented demand from its members compared to its predecessor GATT, which was more power-oriented.

Originally, GATT was supposed to be a part of a bigger complex of agreements in the International Trade Organisation (ITO) that was a conclusion of post-war negotiations in the United Nations Conference on Trade and Employment. The result was an agreement, the Havana Charter, and in cases of conflict between the ITO Members, the International Court of Justice (ICJ) would deal with it.<sup>115</sup>

The GATT 1947 was intended to be of a provisional character until the ITO would enter into force, which it never did. The GATT 1947 was, in several respects, unclear about dispute settlement, and contained several flexible rules that left a lot of room for diplomacy and political power-orientation in cases of dispute between the GATT Contracting Parties. This flexibility in GATT 1947, and the lack of clear guidelines about dispute settlement, also created legal uncertainty. In cases of dispute, the GATT evolved into a system where a Panel of usually three persons – selected by the disputing parties – would make a recommendation about the interpretation of GATT 1947. One of the major issues in the GATT system was that such a Panel recommendation would only have been legally binding on the disputing parties if it was adopted by consensus by all the GATT Contracting Parties – including the losing party. Often, the losing party would use its veto not to accept the Panel recommendation.

From a legal perspective, the GATT system was lacking in transparency and predictability, and the enforcement was vague. The negotiating power between the members could often be decisive, and the GATT system had the character of a political system rather than a legal system. The system has often been described as a power-oriented

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<sup>114</sup> WTO Agreement, Art III.

<sup>115</sup> The Havana Charter, Art. 96.

system.<sup>116</sup> However, during GATT's 50 years of existence before it evolved into the WTO, several agreements were made to clarify the provisions of GATT 1947. These elaborating agreements were concluded in the different trade negotiation rounds between the GATT Contracting Parties during the GATT era. Rules on disputes were also agreed upon to make the procedures for disputes more clear. In 1986, the GATT Contracting Parties started the Uruguay Trade Negotiation Round. The agenda focused on reforming the GATT in a more rule-oriented direction by improving the Dispute Settlement System, and by including services and intellectual property rights under the multilateral system. The result was the WTO, which had a broader range of agreements and an improved Dispute Settlement Body.

The WTO Dispute Settlement Body applies to the WTO members, not to private parties. The disputing parties will first have to try consultancy to reach a satisfactory conclusion themselves. If the consultancy is unsuccessful, the Dispute Settlement Body establishes a Panel, which will come up with a recommendation. That recommendation can be appealed to the Appellate Body. The recommendation from the Panel or, in case of appeal, the Appellate Body, must be adopted by the Dispute Settlement Body. A Panel or Appellate Body recommendation is automatically adopted unless all WTO Members consensually reject the recommendation. This is a different and more rule-based approach compared to the power-oriented GATT system.

The GPA reflects the rule-oriented approach. Compared to its predecessor, the Tokyo GPA, which entered into force in 1981, the present GPA from 1994 is clearer in its language, although there are still several unclear elements. However, the GPA also has a power-oriented mechanism; the Parties to the GPA are not bound by the GPA in every aspect of government procurement. The GPA has a reciprocal nature where the Parties negotiate the individual scope and coverage of which entities and services shall be included within the GPA. For more on this, see section 1.3.2.1 and section 1.3.3. The reciprocal aspects of the GPA might allow more politically powerful Parties to place themselves in a comparatively advantageous position.

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<sup>116</sup> See, for example, J. H. Jackson, 'Global Economics and International Economic Law' (1998) 1 *Journal of International Economic Law* 17; E. U. Petersmann, *The GATT Dispute Settlement System – International Law, International Organisations and Dispute Settlement* (The Hague: Kluwer Law International, 1997), p. 66; H. Andersen, *EU Dumping Determinations and WTO Law* (The Hague: Kluwer Law International, 2009), pp. 23-25 and chapter 2.

Institutionally, the GPA also reflects a rule-oriented approach. Firstly, the GPA is monitored by a Committee on Government Procurement.<sup>117</sup> Each Party must inform the Committee about amendments in national legislation on government procurement and the administration of the legislation.<sup>118</sup> Secondly, disputes between GPA Parties must be notified to the Dispute Settlement Body and eventually – if the parties cannot reach a mutual understanding – a Panel will be established, whose recommendation can be appealed to the Appellate Body.

A private supplier which feels that the public entity has violated the GPA cannot apply to the Dispute Settlement Body but must instead rely on the domestic courts or another impartial body in the country of the government procurement. In contrast to the other WTO agreements,<sup>119</sup> Article XX of the GPA requires the GPA Parties to establish challenge procedures which are non-discriminatory, timely, transparent and effective. The challenge shall be heard by a court or by an impartial and independent review body. Furthermore, in contrast to other WTO agreements, Article XX.7(c) of the GPA requires that the challenge procedure shall provide for correction of the breach of the GPA or compensation for the loss or damages suffered by the private supplier.<sup>120</sup>

The WTO is a rule-oriented system, and the GPA must be seen in that light. The GPA is binding on the Parties, and private suppliers can enforce the GPA in the national systems. However, the GPA is not

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<sup>117</sup> The Committee was already established under the first GPA.

<sup>118</sup> For more details about the information that each GPA Party must submit to the Committee, see Art. XIX.5 of the GPA.

<sup>119</sup> Generally, the WTO agreements do not contain such challenge procedures requiring the WTO members to establish systems where private parties can challenge the WTO member's compliance with the WTO agreements. Under the general WTO framework, it is left to the WTO members individually to decide whether courts shall apply the different WTO agreements. Therefore, the application of WTO agreements by national courts is different from country to country. For example, the application of WTO law before the EU courts is limited to those situations where a Directive or Regulation is intended to implement particular WTO provisions, or the Directive or Regulation has an express reference to the specific WTO provision. See, for instance, Case C-93/02 P *Biret v Council* [2003], ECR I-497, para. 61. The GPA, then, provides a more secure system for the private parties than the general WTO framework.

<sup>120</sup> For a thorough examination of the challenge procedure and the GPA, see S. Arrowsmith, 'The character and role of national challenge procedures under the Government Procurement Agreement' (2002) *Public Procurement Law Review* 235-260.

always clear in its text, and to request clarity of the GPA by the Dispute Settlement Body would be a political decision by the GPA Party of the supplier which feels that the GPA rights are violated by a foreign public entity. Otherwise, clarity can be reached by amending the GPA, which will also be a matter of politics. The GPA Parties have provisionally agreed upon a revised version of the GPA, which is clearer both in text and structure than the present. However, it is uncertain what the final outcome of the revised GPA will be and when it will enter into force.

The following part will briefly list the sources of WTO government procurement law of relevance for PPPs.

#### **2.2.4 Sources of WTO Law of Importance for PPPs and Government Procurement**

Commentators have debated widely on the sources of WTO law. Due to the WTO's international nature, some commentators will delimit the range of sources to those sources deriving from state consent, and thereby see the sources of law being narrowed down to the actual WTO agreements and to the actual state practice reflected in customary law.<sup>121</sup> Other commentators will take a more institutional approach, where the WTO agreements reflect the state interest, but at the same time the WTO as an institution becomes a part of the creation of law, for example by taking the rulings from Panels and Appellate Body into account as part of the range of WTO sources.<sup>122</sup> Others might include an even broader context and include sources of law which are formed outside the WTO framework, such as principles of human rights.<sup>123</sup>

Even though a discussion of the range of sources is very interesting, it lies outside the scope of this chapter. The approach

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<sup>121</sup> For a discussion of this, see M. Matsushita, T. H. Schoenbaum and P. C. Mavroidis, *The World Trade Organisation – Law, Practice, and Policy* (2<sup>nd</sup> ed., Oxford: Oxford University Press, 2006), chapter 2.

<sup>122</sup> For a discussion, see J. E. Alvarez, 'International Organisations: Then and Now' (2006) *American Journal of International Law* 324-347.

<sup>123</sup> See for example E. U. Petersmann, 'Human Rights and International Trade Law – Defining and Connecting the Two Fields', in T. Cottier, J. Pauwelyn and E. Bürgi (eds.) *Human Rights and International Trade* (Oxford: Oxford University Press, 2005), 29-94.

taken in this chapter is a broader one, and the sources of law in this chapter are laid out below.

#### **2.2.4.1 Treaties**

The WTO Agreement and its annexed agreements are binding on the WTO members. Here, the GPA is very important. The other WTO agreements are also important in order to get the full picture of the GPA. For example, both GATT and GATS impose some limitations on State conduct in regard to goods and services which can guide the understanding of the GPA.<sup>124</sup> As mentioned above, it remains unclear whether the MFN principle of GATT applies generally to government procurement.

Other international written sources are important to take into account. The GPA refers, for example, to international standards which could be developed by the International Organisation for Standardization (ISO). Furthermore, international treaties can be taken into account when interpreting the WTO agreements to get an understanding of terms therein;<sup>125</sup> see more in section 1.3.7. The question is whether other international treaties can prevail in cases of conflict with a WTO provision. This is not discussed further in this chapter.

#### **2.2.4.2 Customary law**

Customary law consists of two elements: the practice between states and *opinio juris*, i.e. the sense of obligation to perform the practice. Customary law is the basis of public international law; for example,

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<sup>124</sup> For example, GATT 1994, Art. VI, in conjunction with the WTO Anti-Dumping Agreement, allows the WTO Members to impose anti-dumping duties on products from other WTO Members if the prices are dumped and the industry in the importing country is injured by the dumped prices. The GPA requires that a public entity submits such information if the anti-dumping duty will reflect the evaluation of the tender prices in the awarding phase; cf. Art. XII.2(h).

<sup>125</sup> See, for example, WTO, *United States – Import Prohibition of Certain Shrimp and Shrimp Products- Report of the Appellate Body* (12 October 1998) WT/DS58/AB/R, para. 130

the principle of *pacta sunt servanda*, i.e. that treaties must be performed in good faith, is based in customary law.<sup>126</sup>

In *Korea – Procurement*, the Panel stated that:

Customary international law applies generally to the economic relations between the WTO Members. Such international law applies to the extent that the WTO treaty agreements do not “contract out” from it.<sup>127</sup>

Customary international law applies to the economic relations between states if it is not in conflict with the text of a WTO agreement. Customary international law is written into the WTO agreements and constitutes the basis for the interpretation of WTO agreements.<sup>128</sup> The Panels and Appellate Body find that those customary rules are reflected in the Vienna Convention on the Law of Treaties Article 31 and Article 32.<sup>129</sup> The interpretation tools of the Vienna Convention on the Law of Treaties must be used to clarify the text of the GPA.<sup>130</sup> The question is whether there are specific

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<sup>126</sup> The principle of *pacta sunt servanda* is written into Art. 26 of the Vienna Convention on the Law of Treaties.

<sup>127</sup> WTO, *Korea – Measures Affecting Public Procurement – Report of the Panel* (1 May 2000) WT/DS163/R, para. 7.96 (emphasis added).

<sup>128</sup> See DSU, Art. 3.2.

<sup>129</sup> Other parts of the Vienna Convention on the Law of Treaties also reflect customary international law. In WTO, *Korea – Measures Affecting Public Procurement – Report of the Panel* (1 May 2000) WT/DS163/R, the Panel referred to Art. 48 of the Vienna Convention on the Law of Treaties, which, according to the Panel, reflects the customary international rule of law that an error in a treaty can be grounds for invalidating the treaty or part of it; see para 7.123.

<sup>130</sup> Art. 31 and Art. 32 of the Vienna Convention on the Law of Treaties provide:

“Article 31: General rule of interpretation

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:

(a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;

(b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

3. There shall be taken into account, together with the context:

(a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;



customary rules of international law addressing government procurement specifically. The UNCITRAL Model Law, which is non-binding in its codified version, is apparently a reflection of several countries' government procurement system, and it has apparently been implemented into several national systems.<sup>131</sup> Based on this wide acceptance in state practice, the question is whether some principles from the UNCITRAL Model Law will eventually achieve the status of customary law. However, several countries have procurement laws which are not based on the UNCITRAL Model Law,<sup>132</sup> and it would require a far wider acceptance in state practice before the UNCITRAL Model Law could be regarded as customary international law.

### 2.2.4.3 Principles of law

The WTO itself is based on the above-mentioned non-discrimination principles like the Most-Favoured-Nation principle, which requires a WTO Member not to discriminate between its trading partners, and the National Treatment principle, which requires that a WTO Member does not discriminate between national and foreign products once they have entered into the territory of the respective WTO member. Those principles are also written into the different WTO agreements.

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(b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;

(c) any relevant rules of international law applicable in the relations between the parties.

4. A special meaning shall be given to a term if it is established that the parties so intended.

Article 32: Supplementary means of interpretation

Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:

(a) leaves the meaning ambiguous or obscure; or

(b) leads to a result which is manifestly absurd or unreasonable.”

<sup>131</sup> Z. Xinglin, 'Forum for review by suppliers in public procurement: an analysis and assessment of the models in international instruments' (2009) *Public Procurement Law Review* 201-226, at p. 203.

<sup>132</sup> See A. Kovacs, 'The Global Procurement Harmonisation Initiative' (2004) *Public Procurement Law Review* 15-38, at p. 23. For a rejection of the UNCITRAL Model Law as international law, see: G. Westring, 'Multilateral and unilateral procurement regimes - to which camp does the UNCITRAL Model Law on procurement belong?' (1994) *Public Procurement Law Review* 142-151, at p. 147.

The principle of *jus cogens* also applies to WTO law. Article 53 of The Vienna Convention on the Law of Treaties states that a treaty is void if it is in violation of a peremptory norm of international law (*jus cogens*).<sup>133</sup> *Jus cogens* can for example be prohibition of slavery or genocide. That rule reflects customary international law, and any state acting in violation of such a principle would also act in violation of a WTO treaty, or, put differently, if a WTO agreement allowed slave trade, it would be void.<sup>134</sup> Because of this, several of the WTO agreements contain mechanisms for the protection of human life or safety – in the GPA it follows from Article XXIII. Therefore, a State establishing a PPP may reject a bid – or generally step out of the PPP after the contract has been concluded – if the private party is using slaves in its production to the PPP.

#### 2.2.4.4 Case law

The question here is whether international courts and tribunals can take part in law creation through their judgments. Generally, international courts are not supposed to make rulings binding on future cases. The binding power is often solely related to the actual case. If international courts were making rulings binding on future cases, it would be in conflict with the often state-centric approach in the law creation of public international law.<sup>135</sup> This is reflected in the

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<sup>133</sup> Art. 53 of the Vienna Convention on the Law of Treaties provides: “*Treaties conflicting with a peremptory norm of general international law (“jus cogens”): A treaty is void if, at the time of its conclusion, it conflicts with a peremptory norm of general international law. For the purposes of the present Convention, a peremptory norm of general international law is a norm accepted and recognised by the international community of States as a whole as a norm from which no derogation is permitted and which can be modified only by a subsequent norm of general international law having the same character.*”

See also D. Shelton, ‘Normative Hierarchy in International Law’ (2006) 100 *American Journal of International Law* 291-323.

<sup>134</sup> See J. Pauwelyn, ‘The Role of Public International Law in the WTO: How Far Can We Go?’ (2001) 95 *American Journal of International Law* 535-578, at p. 565.

<sup>135</sup> An example is the decisions from the International Court of Justice (ICJ). Such decisions have no binding force in future cases for the ICJ; see Art. 59 of the Statute of the International Court of Justice. However, the ICJ may apply its former decisions as subsidiary means for the determination of law; see Art. 38.1(d). As a fact, the ICJ often refers to its former decisions.

WTO. According to Article 3.2 of the Dispute Settlement Understanding, that is the rules governing the Dispute Settlement Body, Panels and Appellate Body cannot add to or diminish the rights and obligations written into the WTO agreements. A textual approach suggests that the Panel and Appellate Body only have an interpretative function and that recommendations can only be binding on the parties to the actual case, but cannot bind in future cases. As parts of a rule-oriented system, however, the Panel and Appellate Body cannot ignore their former recommendations, and they always refer to former cases, as such interpretations from former cases create 'legal expectations'.<sup>136</sup>

The line between interpretations creating legal expectations and actual precedence is not clear,<sup>137</sup> and some commentators argue that, in particular, the Appellate Body has overstepped its line by illegitimately taking part in the creation of WTO law,<sup>138</sup> while others

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A different perspective concerns the International Criminal Court (ICC) which may apply principles and rules of law as interpreted in its previous decisions. Yet, it appears to be limited to the interpretations, and the ICC shall apply text and principles of law; see Art. 21 of the Rome Statute of the ICC. It seems there is no requirement that the decisions of the ICC only apply as subsidiary means.

<sup>136</sup> See statement in WTO, *Japan – Taxes on Alcoholic Beverages II – Report of the Appellate Body* (4 October 1996) WT/DS8/AB/R, WT/DS10/AB/R and WT/DS11/AB/R, p. 14. See also L. Nielsen. *The WTO, Animals and PPMs* (Leiden: Martinus Nijhoff Publishers, 2007), pp. 115-123.

<sup>137</sup> See most notably the statement by the Panel in WTO, *US – Final Anti-Dumping Measures on Stainless Steel from Mexico* (20 December 2007) WT/DS344/R, paras 7.115-7.140, where the Panel explicitly stated that it would not follow the line of reasoning developed by the Appellate Body in previous cases. The Panel report was, as expected, overruled by the Appellate Body, WTO, *US – Final Anti-Dumping Measures on Stainless Steel from Mexico – Report of the Appellate Body* (30 April 2008) WT/DS344/AB/R; see in particular para. 162. This case demonstrates one major problem in the WTO judicial system; the guidelines for Panels and Appellate Body are not clear and have contradictory elements, as Panels and Appellate Body must not make binding interpretations in future cases but, at the same time, have to ensure the predictability in the WTO system. See Martti Koskenniemi's interesting and excellent discussion about the argumentation in public international law as a contrast between normativity, i.e. distances from state power, and concreteness, i.e. distances from natural morality. See Martti Koskenniemi, *From Apology to Utopia* (Cambridge: Cambridge University Press, 2005).

<sup>138</sup> See J. Greenwald, 'WTO Dispute Settlement: An Exercise in Trade Law Legislation?' (2003) 6 (1) *Journal of International Trade Law* 117; and D. K. Tarullo, 'Paved with good intentions: the dynamic effects of WTO review of anti-dumping action' (2003) 2 (3) *World Trade Review* 379. See also M. Matsushita, T.

suggest that recommendations from Panels and Appellate Body should be accepted as a source of WTO law.<sup>139</sup>

In relation to the GPA, there were a few cases under the former GPA, the Tokyo GPA, before the WTO was established.<sup>140</sup> The interpretations from those Tokyo GPA cases have legal value if they were adopted under the former system.<sup>141</sup> Since the establishment of the WTO, there have been only three disputes concerning the present GPA. Two of those never came through the Panel procedure. *Japan – Procurement of a Navigation Satellite*<sup>142</sup> concerned the specifications of the tender to the US system. The EU claimed it violated the non-discrimination principle and the rules on technical specification. Japan and the EU reached a mutually agreed solution and therefore no Panel was established.<sup>143</sup> In *US – Procurement*,<sup>144</sup> in which both the EU and Japan claimed that the US violated the rules about selection procedures and qualification of suppliers because the entities in the state of Massachusetts were not allowed to procure goods or services from any persons who did business with Burma, a Panel was established, but the parties later requested the Panel to suspend its work, and it was not asked to resume its work. The case later expired. *Korea – Procurement*<sup>145</sup> is the only GPA case that has resulted in a Panel recommendation. The case concerned definitions of Korean government entities covered by the GPA.<sup>146</sup>

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H. Schoenbaum & P. C. Mavroidis, *The World Trade Organisation – Law, Practice, and Policy* (2nd ed., Oxford: Oxford University Press, 2006), 908-910.

<sup>139</sup> See for example R. Bhala, *Modern GATT Law – A Treatise on the General Agreement on Tariffs and Trade* (London: Sweet & Maxwell, 2005), pp. xvii-xviii.

<sup>140</sup> WTO, *EEC – Value-Added Tax (VAT) and Threshold – Report of the Panel* (16 May 1984) BISD 315/247; WTO, *United States – Procurement of a Sonar Mapping System – Report of the Panel* (23 April 1992) GPR.DS1/R; WTO, *Norway – Tendering Procedures on Trondheim Toll Ring Project – Report of the Panel* (28 April 1993) BISD 405/319.

<sup>141</sup> See statement in WTO, *Japan – Taxes on Alcoholic Beverages II – Report of the Appellate Body* (4 October 1996) WT/DS8/AB/R, WT/DS10/AB/R and WT/DS11/AB/R, p. 14.

<sup>142</sup> WTO, *Japan – Procurement of a Navigation Satellite* (1 April 1997) WT/DS73, no report issued.

<sup>143</sup> WTO, Notification of Mutually-Agreed Solution (3 March 1998) WT/DS73/5.

<sup>144</sup> WTO, *United States – Measure Affecting Government Procurement* (12 February 1999) WT/DS88 and WT/DS95, no report issued.

<sup>145</sup> WTO, *Korea – Measure Affecting Government Procurement – Report of the Panel* (1 May 2000) WT/DS163/R.

<sup>146</sup> See more in section 1.3.3.1.

Based on those sources, the next section examines the GPA in relation to PPPs.

### 3. The GPA

#### 3.1 Introduction

The GPA is included in annex 4 to the WTO Agreement, which contains the plurilateral agreements. The GPA is only binding on those members that have accepted the GPA, and does not create rights or obligations for the other WTO Members.<sup>147</sup> The GPA regulates government procurement between 40 members. There are another 23 WTO members with an observer status in the GPA.<sup>148</sup> Out of those 23 WTO members with observer status, 9 WTO Members are negotiating on accepting the GPA.<sup>149</sup> Besides those 9 WTO members negotiating on entering the GPA, Armenia,<sup>150</sup> Croatia,<sup>151</sup> the Former Yugoslav Republic of Macedonia (FYROM),<sup>152</sup> Mongolia<sup>153</sup> and Saudi

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<sup>147</sup> WTO Agreement, Art. II.3.

<sup>148</sup> Those WTO Members are: Albania, Argentina, Armenia, Australia, Bahrain, Cameroon, Chile, China, Colombia, Croatia, Georgia, India, Jordan, the Kyrgyz Republic, Moldova, Mongolia, New Zealand, Oman, Panama, Sri Lanka, Chinese Taipei and Turkey.

<sup>149</sup> Those 9 WTO members are: Albania, China, Georgia, Jordan, the Kyrgyz Republic, Moldova, Oman, Panama and Chinese Taipei.

<sup>150</sup> WTO, *Report of the Working Part on the Accession of Armenia*, (26 November 2002) WT/ACC/ARM/23, para. 153; WTO, *Decision of Accession of Armenia of 10 December 2002* (17 December 2002) WT/L/506, Part I.2.

<sup>151</sup> WTO, *Report of the Working Party on the Accession of Croatia* (29 June 2000) WT/ACC/HRV/59, para. 156 and para. 225; WTO, *Decision of the Accession of Croatia of 17 July 2000* (3 August 2000) WT/ACC/HRV/60; WTO, *Protocol of the Accession of Croatia* (19 September 2000) WT/ACC/HRV/61, Part I.2.

<sup>152</sup> WTO, *Report of the Working Part on the Accession of the Former Yugoslav Republic of Macedonia* (26 September 2002) WT/ACC/807/27, para. 177 and para. 255; WTO, *Decision of Accession of the Former Yugoslav Republic of Macedonia of 15 October 2002* (18 October 2002) WT/L/494, Part. I.2.

<sup>153</sup> WTO, *Report of the Working Party on the Accession of Mongolia* (27 June 1996) WT/ACC/MNG/9, para. 59 and para. 61; WTO, *Decision of Accession of Mongolia of 18 July 1996* (25 July 1996) WT/ACC/MNG/10; WTO, *Protocol of the Accession of Mongolia* (25 July 1996) WT/ACC/MNG/11, Part. I.2.

Arabia<sup>154</sup> have all respectively written provisions into their Protocols of Accession to the WTO about acceding to the GPA.

This part looks further into both the material and procedural rules of the GPA. First, the part describes the aims of the GPA and its overall principles. Second, the part describes the scope and coverage of the GPA. Third, the product requirements that a public entity can make will be discussed. Fourth, the different tender procedures will be discussed. Fifth, the section discusses the criteria to select the potential suppliers to the government procedure for the PPP. Sixth, the award criteria will be discussed. Finally, the formal aspects of the procurement, such as tender documentation and publication of notices are described.

## **3.2 Aims and Principles**

In line with the general aim of the WTO, the GPA has an economic and non-discriminatory purpose, and aims at achieving greater liberalisation, expanding world trade and applying the non-discrimination principles. In order to avoid arbitrary tender awarding, the GPA aims at increasing the transparency of laws, regulations, procedures and practices regarding government procurement. Furthermore, the GPA aims to provide special and differential rules for developing and in particular least-developed countries, as their development, financial and trade needs should be taken into account in government procurement.

The GPA aims are reflected in the underlying principles of the GPA. Those principles are Non-Discrimination, National Treatment, Transparency, and Special and Differential Treatment for Developing Countries.

### **3.2.1 The Non-Discrimination Principle**

In a WTO context, non-discrimination is often associated with the MFN principle and the National Treatment principle. The GPA is no exception to this, although the term ‘MFN’ has been abandoned. Non-

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<sup>154</sup> WTO, Report of the Working Party on the Accession of the Kingdom of Saudi Arabia (1 November 2005) WT/ACC/SAU/61, paras. 231 and 315; WTO, *Decision of Accession of the Kingdom of Saudi Arabia of 11 November 2005* (11 November 2005) WT/L/627, Part. I.2.

discrimination is central in ensuring a fair competition on the government procurement market. The focus in this part is on the general concept of non-discrimination and its MFN character in the GPA. The following part focuses on the National Treatment principle.

Article III.1(b) of the GPA requires the GPA Parties not to treat products, services and suppliers from some Parties less favourably than is they treat products, services and suppliers from other Parties. In the GPA text, it is not referred to as a MFN treatment, although it shares several similarities with a MFN principle. The difference between the general MFN principle and the GPA lookalike is that the GPA coverage of entities and products is based on reciprocity; that is, the GPA Parties can in their coverage schemes arrange different treatment between the GPA Parties depending on the reciprocal arrangements.<sup>155</sup> For example, even though Canada and Japan are parties to the GPA, the GPA does not apply to Canadian bids on Japanese procurement of several Japanese sub-central government entities, whereas the GPA applies to all the other GPA parties.

Another deviation from the traditional MFN principle is that the non-discrimination between trading partners is limited to only covering the GPA parties and not the other WTO Members that are not parties to the GPA. For example, the authorities in Singapore must not discriminate between potential suppliers from Denmark and the US, but Singapore is allowed to treat the potential suppliers from Denmark and the US more favourably than potential suppliers from a non-GPA party. As mentioned above, however, the question remains whether the MFN principle from GATT 1994 applies to government procurement of goods, i.e. whether the MFN principle can be applied by non-GPA Parties in situations with government procurement of goods. This is not resolved in practice, and it is subject to a range of opinions from different commentators.<sup>156</sup> What is clear, however, is that the MFN principle concerning services in GATS does not apply to government procurement. In that respect, only the GPA applies to government procurement of services. Therefore, a public entity which establishes a PPP consisting of services that are covered by the GATS will not be bound by the MFN principle in GATS, and the public

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<sup>155</sup> See also C. Bovis, 'The New Public Procurement Regime: A Different Perspective on the Integration of Public Markets of the European Union' (2006) 12 (1) *European Public Law* 73-109 at p. 104. See more in section 1.3.3.

<sup>156</sup> See above in section 1.2.2.2.

entity can, therefore, arrange better treatment to the GPA Parties than the other WTO Members.

Another aspect of the non-discrimination principle is written into the GPA, Article III.2(a). A public entity must not treat a locally-established supplier less favourably than another locally-established supplier on the basis of degree of foreign affiliation or ownership. That rule implies that the non-discrimination principle applies to situations where two potential suppliers are established in the country of the public entity. The cross-border aspect is the affiliation or ownership of one of the potential suppliers. A public entity may not favour a potential supplier with less or no foreign owners over a potential supplier with foreign affiliation or ownership, nor may the public entity favour a potential supplier with foreign affiliation or ownership over a completely locally owned potential supplier. For example, there could be the situation where the government policy would favour the attraction of foreign investment in a PPP from a domestically established potential supplier that is fully or partly owned by foreign shareholders, and not allow domestically owned suppliers to make a bid. Such reverse discrimination is not allowed under the GPA.

Article III.2(b) provides that a public entity may not discriminate against locally established suppliers on the basis of the country of production of the goods or service being supplied, provided that the country of production is a Party to the GPA in accordance with the rules of origin, which is described in section 1.3.4.2.

### **3.2.2 The National Treatment Principle**

Article III.1(a) of the GPA codifies the National Treatment principle. A GPA party may not treat products, services, or suppliers from the other parties less favourably than the treatment accorded to domestic products, services and suppliers.

A public entity which desires to establish a PPP cannot require that the products provided by the private supplier only be products originating in the country of the public entity.

In line with the non-discrimination principle and the national treatment principle, the GPA does not allow a public entity to impose, seek or consider offsets in the qualification and selection of suppliers, products and services, or in the evaluation of tenders and award of



contracts.<sup>157</sup> *Offsets* are defined in the GPA as measures used to encourage local development or improve the balance-of-payments accounts by means of domestic content, licensing of technology, investment requirements, counter-trade or similar requirements.<sup>158</sup> However, offsets can be allowed in situations with developing and least-developed countries.<sup>159</sup>

### 3.2.3 Special and Differential Treatment for Developing Countries

Article V concerns special rules and differential rules for developing and least-developed countries. Article V.1 states the objectives; the development, financial and trade needs of developing and in particular least-developed countries must duly be taken into account by the developed countries. The rule, however, is limited to concern the need for developing and least developed countries: to safeguard their balance-of-payments position; to promote the establishment or development of domestic industries; to support industrial units which are dependent on the government procurement; and to encourage economic development through regional or global arrangements among developing countries. Those objectives must be taken into account in the negotiation of developing and least-developed countries to enter the GPA.

In the preparation and application of laws, regulations and procedures affecting government procurement, the developed GPA Parties shall facilitate increased imports from least-developed countries, bearing in mind the special problems of least-developed countries and of those countries at low stages of economic development.<sup>160</sup> This rule only requires facilitated import from developing and least-developed countries. The rule does not imply that a public entity from a developed country shall favour a bid from a supplier from a developing country over a bid from a supplier from a developed country.

Article V.4 provides that a developing country may negotiate exclusions to the National Treatment Principle with respect to certain entities, products and services, which are written into its Annexes; see more in section 1.3.3 about the Annexes. The exclusion depends on a

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<sup>157</sup> Art. XVI.1 of the GPA.

<sup>158</sup> Art. XVI.1 of the GPA, footnote.

<sup>159</sup> Art. XVI.2 of the GPA.

<sup>160</sup> Art. V.2 of the GPA.

mutual agreement with the other GPA parties, although the developed GPA Parties shall take the above-mentioned objectives into account. Also, the GPA allows for developing and least-developed countries to modify the coverage of entities and products under the GPA after the entry into force of the GPA.<sup>161</sup>

Developing countries may also seek offsets, for example by encouraging local development or improving the balance-of-payments accounts, in the qualification to participate in the procurement – not as awarding criteria. In order to seek offsets, the developing country must negotiate the conditions for their application.<sup>162</sup>

The special and differential treatment rules for developing and least-developed countries have several unclear and critical elements:

- There is no definition of developing and developed countries in the WTO framework. A GPA Party must define itself as a developing or developed country. However, a GPA Party cannot define itself as a developing country without getting through a political debate with the other GPA Members, who might not allow the country to categorise itself as a developing country. Only least-developed countries are defined in accordance with the definition provided by the UN;<sup>163</sup>
- In particular, the least-developed countries might not have the negotiation power to achieve exceptions like the exception to the National Treatment Principle;
- The text of Article V is very vaguely formulated. In case of a dispute, the question is whether a Panel will be hesitant to read the provision, the objectives in particular, as one imposing obligations on developed countries.<sup>164</sup>

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<sup>161</sup> Art. V.5 of the GPA.

<sup>162</sup> Art. XVI.2 of the GPA.

<sup>163</sup> See United Nations Conference on Trade and Development (UNCTAD); <http://www.unctad.org/>

<sup>164</sup> See Panel practice in the anti-dumping area: WTO, *United States – Anti-Dumping and Countervailing Measures on Steel Plate from India – Report of the Panel* (28 June 2002) WT/DS206/R, para. 7.110. The question is whether the GPA is clear in defining any obligations on developed countries. See also panel in WTO, *European Communities – Anti-Dumping Duties on Malleable Cast Iron Tube or Pipe Fittings from Brazil – Report of the Panel* (7 March 2003) WT/DS219/R, para. 7.68.

The special and differential rules for developing and least-developed countries have not appealed to the developing and least-developed countries. Interestingly, as seen above, several international organisations, including the WTO, promote the idea of PPPs in developing and least-developed countries to improve infrastructure, etc. It is possible that the rejection of the GPA causes some suppliers to refrain from investing in PPPs in non-signatory countries, given that the GPA could provide some legal certainty for those suppliers.<sup>165</sup>

### 3.2.4 Transparency

Transparency is a keyword in government procurement. On the one hand, transparency ensures that different suppliers of products and services become aware of the potential government procurement in order to let the public entity know of their products. Therefore, transparency reduces the transaction costs. On the other hand, transparency ensures control, to some extent, with the public entity not favouring or discriminating between the different suppliers. Hence, transparency limits the opportunity for arbitrary contract awards and limits bribery.

The GPA and its enforcement system contain several rules reflecting the transparency principle. As mentioned above, the GPA Parties must inform the Committee on Government Procurement about changes in legislation. Thereby, such changes will be known by the other GPA Parties. Furthermore, Article XIX obligates the GPA Parties to collect and provide to the Committee, on an annual basis, statistics on its procurements covered by the GPA; and each GPA Party must, upon request from another GPA Party, provide information concerning procurement by covered entities and their individual contract awards. There is, however, an exception concerning confidential information.<sup>166</sup>

Furthermore, the GPA contains rules about the tendering procedures applicable to government procurement as well as rules on

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<sup>165</sup> The GPA has been criticized for not being appropriate to developing and least-developed countries. See for example V. Guimaraes De Lima e Silva, 'The revision of the WTO Agreement on Government Procurement: to what extent might it contribute to the expansion of current membership?' (2008) *Public Procurement Law Review* 61-98, at pp. 68-81.

<sup>166</sup> Art. XIX.4 of the GPA.

how the public entity informs the potential suppliers about the procurement, tender award etc.

### **3.3 Scope and Coverage**

Generally, the GPA covers all types of goods. Concerning services and constructions services, the GPA is more limited, as it only applies to services and construction services written into country-specific schedules. Furthermore, the GPA is limited because the parties can make individual thresholds and, to some extent, individually determine which entities shall be covered by the GPA.

The limitation for both goods and services is the thresholds each party has made, and the covered entities. The threshold is measured by Special Drawing Rights (SDR), which is a basket composition of different currencies consisting of the Euro, Japanese Yen, Pound Sterling, and US Dollars. The SDR is based on specific amounts of each of the four currencies, and it is valued in US Dollars. The SDR is updated on a daily basis on the exchange rates of the four currencies. The SDR was created by the International Monetary Fund (IMF).<sup>167</sup> Each time a covered entity is procuring for no less than the threshold, the GPA applies.<sup>168</sup>

The GPA contains an Appendix I concerning those limitations. The Appendix I is individually made for each party to the GPA. Appendix I is an integral part of the GPA,<sup>169</sup> and it can be found on the WTO website.<sup>170</sup> The Appendix I contains five annexes and general notes.

#### **3.3.1 The Annexes: Thresholds, Entities, Services, and Construction Services**

The five Annexes to each GPA Party's Appendix 1 concern which entities are covered by the GPA, and the thresholds for goods and services covered by the GPA.

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<sup>167</sup> See more information about SDR on the web-page of the International Monetary Fund: <<http://www.imf.org/external/np/exr/facts/sdr.htm>> accessed 30 November 2010.

<sup>168</sup> GPA, Art. I.4.

<sup>169</sup> GPA, Art. XXIV.12.

<sup>170</sup> See <[http://www.wto.org/english/tratop\\_e/gproc\\_e/appendices\\_e.htm](http://www.wto.org/english/tratop_e/gproc_e/appendices_e.htm)> accessed 30 November 2010

Annex 1 contains the *central government entities* which are under the GPA. For example, South Korea has written into its Annex 1 a number of central government entities covered by the GPA with a threshold of 130,000 SDR for goods. Therefore, each time one of those central government entities mentioned on the South Korean list, e.g. the Korean Ministry of Land, Transport and Maritime Affairs, is buying goods for a value of 130,000 or above, the GPA applies. For example if the Ministry were to buy goods to work on infrastructure in South Korea and enter a PPP, the GPA would apply to such an arrangement.

Annex 2 contains the *sub-central government entities* which are under the GPA. For example, South Korea has written a list of such entities, like the Seoul Metropolitan Government, with a threshold of 200,000 SDR for goods.

Annex 3 contains *all other entities* that are covered by the GPA. South Korea has, for instance, written Korea Highway Corporation into the list of several entities covered by the GPA. The threshold for goods is 450,000 SDR.

Annex 4 contains the *services* covered by the GPA. Each Party can make its individual list of services. The lists of each Party can be a positive or negative. For example, South Korea has made a positive list of services covered by the GPA. All other services are excluded from the GPA. Therefore, if one of the entities mentioned in Annex 1, 2, or 3 are entering into a PPP concerning one or more of the services explicitly mentioned in Annex 4, the entity must follow the procedures in the GPA.

Annex 5 contains the list of *construction services* covered by each GPA Party respectively. To continue with the South Korea example, it has made a positive list of such services covered by the GPA. Furthermore, there are different thresholds depending on whether the entity is a central public entity (Annex 1), a sub-central public entity (Annex 2), or one of the other entities (Annex 3) covered by the GPA. For central government entities the threshold of construction services is 5,000,000 SDR; for sub-central government entities the threshold is 15,000,000 SDR; and for all other entities the threshold for construction services is also 15,000,000 SDR.

The country-specific lists of entities covered by the GPA, which each GPA Party writes into Annex 1, 2 or 3, are not always clear in their definitions. That was the case in *Korea – Procurement*. In the specific case, the US claimed that ‘branch offices and subsidiary organisations’ were included under the list of Korean entities covered

by the GPA. The South Korean commitment provides: ‘The above central government entities include their subordinate linear organisations, special local administrative organs, and attached organs as prescribed in the Government Organisation Act of the Republic of Korea’. The Panel, however, did not find such basis to include branch offices and subsidiary organisation under the list, and the claim of the US was rejected.<sup>171</sup>

All the services and construction services that each party to the GPA mentions – whether positively or negatively – in their Annexes 4 and 5 are categorised in the *WTO Service Sectoral Classification List*.<sup>172</sup> That system has its own numbering of the different services. For example, ‘Refuse disposal services’ is listed under number ‘6.B’. However, the WTO classification system refers to the *Central Product Classification* (CPC) system, which is an international classification system of goods and services used by the UN Statistics Division.<sup>173</sup> The latter is much more detailed than the WTO system. The ‘Refuse disposal services’ is numbered ‘9402’ under the old CPC system. One problem with the double classification system is that neither the WTO Service Sectoral Classification List, nor the Annexes of the parties to the GPA are updated in accordance with the updates of the CPC. The CPC system referred to in the WTO system and in the Annexes is the provisional CPC.<sup>174</sup>

Some of the GPA Parties refer to both systems, and where the WTO system is not explicit about one of the services mentioned in the CPC, the WTO system categorises such services as ‘other’ services. South Korea, for example, refers to both systems. Some parties only refer to the CPC system in situations where the WTO system is not explicit about the service. See, for example, Japan, which includes Building-cleaning services in its Annex 4, but only refers to CPC number 874. Finally, other parties, like the EU, only refer to the CPC system.<sup>175</sup>

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<sup>171</sup> WTO, *Korea – Measures Affecting Government Procurement – Report of the Panel* (1 May 2000) WT/DS163/R, paras. 7.14-7.83.

<sup>172</sup> WTO, *Services Sectoral Classification List - Note by the Secretariat* (10 July 1991) MTN.GNS/W/120.

<sup>173</sup> See for more information about CPC on:

<<http://unstats.un.org/unsd/class/default.asp>> accessed 30 November 2010

<sup>174</sup> See the provisional CPC on:

<<http://unstats.un.org/unsd/cr/registry/REGCST.asp?Cl=9&Lg=1>> accessed 30 November 2010

<sup>175</sup> See the Annex 4 of the EU.

### 3.3.2 The General Notes

Besides the five Annexes, Appendix 1 includes each GPA Party's *General Notes*, which are also an integral part of the GPA.<sup>176</sup> The general notes reflect the reciprocal character of the GPA – and the exception to the MFN principle – by discriminating between the GPA Parties. For example, as mentioned above, the GPA does not apply to Canadian bids on Japanese procurement by several Japanese sub-central government entities, whereas the GPA applies to all the other GPA parties. That follows from the general notes of Japan. Another example is the United States' general notes, which provide that, for construction services, the GPA applies only to procurement of the entities listed in Annexes 2 and 3 above a threshold of 15 million SDR for suppliers from South Korea, whereas the threshold in Annex 2 and 3 is 5,000,000 SDR for other GPA Parties. Also, the GPA does not cover construction services of US central governmental entities (Annex 1) for South Korean bids. So, in respect to such construction services, the US gives the other GPA Parties better treatment than it gives South Korea.

If a public purchase is under the threshold, or it is the purchase of a service or a construction service not listed in the Annexes, the GPA does not apply.

### 3.3.3 Calculation of the Estimated Value of the Contracts

In Article II, the GPA provides special rules for the public entity with regards to calculating the value of the contracts. The idea is to avoid the public entities circumventing the GPA by using a calculation method which will lower the contract value to a level below the threshold to the benefit of certain suppliers. In a footnote the GPA provides that the GPA applies to those government contracts which are estimated to be equal to or above the thresholds.<sup>177</sup> Therefore, if for example a US central public entity wants to establish a PPP concerning, for example, translation services, and the estimate of the value of the contract is exactly 130,000 SDR, which is the US

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<sup>176</sup> Art. XXIV.12 of the GPA.

<sup>177</sup> Art. II.1, footnote 2.

threshold for services for central government entities, the GPA applies.<sup>178</sup>

The valuation shall take all forms of remuneration, including premiums, fees, commissions and interest into account. In its method of calculating the value, the public entity must not circumvent the GPA by lowering the valuation, for example by dividing the procurement requirements, or in any other way<sup>179</sup>

In those situations where more than one contract is awarded, or the award is separated into parts, it follows from Article II.4, a and b, that the entity then must choose between finding a basis from the actual value of other contracts that are both similar, or from recurring contracts like the one offered for the procurement. Those other contracts shall have been concluded within the previous fiscal year or 12 months, adjusted, where possible, for anticipated changes in quantity and value over the subsequent 12 months; or finding a basis in an estimated value of recurring contracts in the fiscal year or 12 months subsequent to the initial contract.

Article II.4 does not suggest any hierarchy between those two methods for calculating the value, but apparently Article II.4 exhausts the methods, i.e. the entity cannot use any other method than those two mentioned here. One problem would, however, occur in situations where the entity has neither other similar and recurring contracts nor other just recurring contracts to base the valuation on. Also, from the wording, it appears that the basis for valuation cannot be based solely on one other contract; see the plural form, ‘contracts’, in Article II.4 a and b.<sup>180</sup>

Article II.5 concerns contracts for the lease, rental or hire purchase of products or services, or contracts that do not specify a total price. In such cases, the basis for evaluations shall be:

- (a) in the case of fixed-term contracts, where their term is 12 months or less, the total contract value for their duration, or, where their term exceeds 12 months, their total value including the estimated residual value; (b) in the case of contracts for an indefinite period, the monthly installment multiplied by 48.<sup>181</sup>

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<sup>178</sup> See United States, Appendix I, annex 1.

<sup>179</sup> Art. II.2 and Art. II.3.

<sup>180</sup> That would follow from the textual interpretation.

<sup>181</sup> Art II.5 of the GPA.



It is further provided that in cases of doubt, the valuation method in (b) shall be used.

### **3.4 Product Requirements and other limitations**

The GPA imposes limitations on the public entity if it wants to make product requirements. For example, a public entity might require that the PPP partner may only use products with a specific shape. It has already been mentioned above that the product requirement may not be based on offsets. Besides the limitation on offsets, the product requirements are limited in relation to technical specifications and rules of origin.

- Technical specifications; it will be a violation of the non-discrimination principle if a public entity could freely decide only to procure products with, for example, a specific trademark. That would give the public entity an option to make arbitrary decisions and for example only allow the trademark owner to make bids to enter the PPP.
- Rules of origin; the public entity might find itself in a situation where the private party performing in the PPP is using final products which contain product elements that are imposed with an anti-dumping duty from the country where the public entity is located. For example, consider that the EU has imposed an anti-dumping duty on pre-manufactured cotton cloth from India. A public entity from an EU member state is interested in building a hospital as a PPP where the private supplier is purchasing the bed linen for the hospital beds in South Korea, but the South Korean bed linen is made of the cotton cloth from India. The question in this situation is whether the public entity can reject the bed linen from the potential supplier.

The following parts look further into the technical specifications and rules of origin.

#### **3.4.1 Technical Specifications**

The GPA regulates technical specifications in Article VI. The provision deals with both the actual requirements for technical specifications imposed by a public entity and the level of advice for preparing the procurement that a public entity can seek from a

potential supplier or other with interest in the procurement. Both will be addressed in the following.

#### **3.4.1.1 Technical Requirements**

It follows from paragraph 1 that technical specifications about quality, performance, safety and dimensions, symbols, terminology, packaging, marking and labelling, or the processes and methods for their production and requirements relating to conformity assessment procedures prescribed by the procuring entity shall not be prepared, adopted or applied with a view to, or with the effect of, creating unnecessary obstacles to international trade. Therefore, a public entity is allowed to make technical specifications, for example to require specific quality measures being reached by the supplier, but any intent or effect of technical specifications creating unnecessary obstacles to the trade is not allowed. It is worth noticing the term ‘unnecessary obstacles’. This might imply that there can be situations where there can be obstacles to trade which are necessary; for example, in order to fulfil some safety requirements, a public entity can require that the product instructions are translated into the language of country where the public entity is established.<sup>182</sup>

Article VI.2 concerns requirements for technical specifications. Technical specifications shall, where appropriate, be in terms of performance rather than design or descriptive characteristics, and the technical specifications shall be based on international standards, like, for example, the standards developed by the International Organization for Standardization (ISO). If no international standards exist, then the technical specifications shall be based on national technical regulations, recognised national standards or building codes.

The public entity is not allowed to require or make reference to a specific trademark, patent, design or type, specific origin, producer or supplier; see Article VI.3. Only in a situation where there is no sufficiently precise or intelligible way to describe the product in the procurement requirements, the public entity will be allowed to do so if a term such as ‘or equivalent’ is written into the tender documentation.

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<sup>182</sup> For a thorough examination of this, see: S. Arrowsmith, *Government Procurement in the WTO* (The Hague: Kluwer Law International, 2003), pp. 312-317.

### 3.4.1.2 Advice on Technical Specifications

Due to the complex nature of PPP, public entities might seek advice from the potential suppliers to formulate and specify the needs of the public entity. It is seen in chapter 4 that the EU uses the competitive dialogue as a means to achieve the flexibility required in such complex arrangements. Article VI.4 of the GPA imposes limitations on such dialogues. It follows that the public entity shall not seek or accept advice about the specific procurement from suppliers with a commercial interest in the procurement, if doing so would result in a preclusion of the competition. The '*firm*' would here be any potential supplier to the PPP as well as other companies with a commercial interest in the PPP. However, advice can be sought if the competition is not precluded.

The emphasis on '*competition*' does not imply that the non-discrimination rules are abandoned. Article VI.4 must be seen in light of the non-discrimination rules; that is, a public entity cannot seek advice only from a national private supplier, but must first ensure that seeking advice in the preparation of technical specifications is not a violation of the non-discrimination and national treatment rules in Article III. If the public entity fulfils the requirements in Article III and can seek advice from a private party with commercial interest in the PPP, e.g. a supplier, without violating Article III, the public entity must do it in a manner that will not preclude the competition. One possible option is to seek advice from all the potential suppliers and engage with them about specific solutions to the complex character of the PPP. For example, if the specifications have been determined with the advice from a potential private supplier to the PPP, the specifications for the product must not be company-specific for that advising supplier. The specifications must be made in a manner where other suppliers, given the actual market structure, can suggest a like product to the one produced by the advising supplier. Even in situations where the potential supplier holds a patent for a product which could be of interest to the public entity, the result of the preparation of the procurement must be open to include products around the patent as long as those products are not violating the patent owner's right.

If the public entity seeks advice from potential suppliers, the question is whether it is possible to keep some information from one

supplier away from other suppliers due to confidentiality; see Article XIX.4 of GPA. It will be left to the public entity to decide what information from a potential supplier is of a confidential character. Certainly, some information, like trade secrets, must not be revealed to the other potential suppliers. However, the public entity cannot keep all sorts of information confidential when the dialogue concerns the definition and refinement of its own needs. For example, all the characteristics of the product, i.e. the output needed by the public entity, must be revealed. Otherwise, the rule of confidentiality could be used to circumvent the GPA and prevent competition.

Article VI.4 is a limitation on the public entity's option of engaging in a dialogue with the potential suppliers to define the needs of the public entity with regards to the often complex aspects in a PPP if the outcome of such dialogue cannot be revealed to the other potential suppliers.

Besides the limitations on the seeking of advice on technical specifications from potential suppliers, it is not clear from Article VI whether the public entity can seek advice on matters not related to technical specifications. For example, in the case of PPPs, there can be organisational and financial matters concerning the structure of the partnership which it could be important for the public entity and potential suppliers to discuss before the exact need of the public entity is clearly established. The headline of Article VI is 'technical specification', which indicates that the negotiators of the GPA intended only to regulate technical specifications and not other specifications. However, Article VI.4 only mentions 'specifications', whereas paragraphs 1 and 2 of Article VI both mention 'technical specifications'. Based on the actual wordings of Article VI.4, it can be argued that 'specifications' in the sense provided in Article VI.4 is broader than the sense provided in Article VI.1 and Article VI.2. Had the drafters of the GPA wanted Article VI.4 to be limited to only concern 'technical specifications', they would have written it into Article VI.4. From that perspective, Article VI.4 will also include specifications concerning matters other than the 'technical specifications' referred to in Article VI.1 and Article VI.2.

### **3.4.2 Rules of Origin**

The GPA regulates rules of origin in Article IV. Generally, the rules of origin concern the determination of where a product originates.

Although the WTO facilitates trade between its members, there are several exceptions where a WTO member can impose obstacles to products from other countries, for example where there is unfair trade like dumping or subsidised products.<sup>183</sup>

GPA Parties shall not apply other rules of origin in relation to government procurement than they do in the normal course of trade. Nor shall the GPA Parties apply rules of origin different from those applied at the time of the transaction in question to imports or suppliers of the same products or services from the same parties.

Generally, the WTO members have established a work programme to harmonize the rules of origin.<sup>184</sup> The result from that work programme shall be taken into account by the GPA Parties.<sup>185</sup>

### **3.5 Procedures**

As seen above, the GPA imposes limitations on a dialogue between a public entity and potential suppliers when defining and shaping the needs of the public entity concerning specifications in the preparation of the procurement. It is also necessary to ascertain whether the tendering procedures under the GPA allow for the flexibility needed in PPP arrangements. The following part will describe the procedures allowed by the GPA.

#### **3.5.1 General Rules on Procedures**

The GPA offers three types of procedures in which the public entity can enter into a contract with a private party: open tendering, selective tendering, and limited tendering. There is no hierarchy between the open tendering procedure and the selective tendering procedure.<sup>186</sup> The limited tendering procedure is an exception and can only be used if certain conditions are met.<sup>187</sup>

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<sup>183</sup> See GATT 1994, Art. VI and Art. XVI and the related Agreements: Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade, and Agreement on Subsidies and Countervailing Duties.

<sup>184</sup> See Art. 9 in the Agreement on Rules of Origin.

<sup>185</sup> Art. IV.2 of the GPA.

<sup>186</sup> S. Arrowsmith, *Government Procurement in the WTO* (The Hague: Kluwer Law International, 2003), 181.

<sup>187</sup> Art. XV.1 of the GPA.

The three procedures can include negotiations under specific circumstances. The negotiation aspect is examined in section

The GPA does not offer a specific procedure for PPPs. The GPA does not explicitly deal with the need for flexibility to discuss and refine the needs of the public entity, as, for example, the competitive dialogue offered by the EU does. Without explicit reference to such a procedure, the question is whether the GPA provides sufficient flexibility to include such a dialogue under the three procedures or the negotiation option. Put differently, to what extent may the public entity use the potential suppliers to discuss, refine and shape the overall goal at which the public entity is aiming? Clearly, there is a difference between the task of buying 200 school tables and the task of building, running and maintaining a school; the latter cannot be easily defined in an invitation notice to submit tenders, and it may require expert advice from the potential suppliers about the actual limitations on their performance ability.

### **3.5.1.1 Open Tendering Procedure**

The open tendering procedure in the GPA requires that all interested suppliers may submit tender to the public entity.

In the case of PPPs, some of these procedures might not be appropriate. As PPPs often involve complex legal, economic, and organisational arrangements between the public entity and the private party, the open tendering procedure seems unsuitable, since it can be very costly. The public entity would not be allowed to just pick out a few tenders to make the dialogue. Therefore, an open procedure may not be suitable to highly integrated partnerships like the Institutional PPP (IPPP).<sup>188</sup>

### **3.5.1.2 Selective Tendering Procedure**

By applying the selective tendering procedure, only those suppliers which have been invited by the public entity may submit tenders.<sup>189</sup> Article X.1 provides that to ensure optimum effective international competition, the public entity must invite tenders from the maximum number of domestic suppliers and suppliers of other GPA Parties,

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<sup>188</sup> See more in chapter 2.

<sup>189</sup> Art. VII.3(b) of the GPA.

consistent with the efficient operation of the procurement system. The public entity must select the suppliers to participate in the procedure in a fair and non-discriminatory manner.<sup>190</sup> The public entity, therefore, seems to have limited discretion to decide on the number of participants in the procedure with respect to fairness, non-discrimination and international competition. Apparently, the limitation in the number of participants can only find justification in the operation of the procurement system.<sup>191</sup>

By applying the selective tendering procedure, the public entity is then in a position to use a two-step procedure:

- First, there is a qualification procedure. The interested suppliers make themselves known to the public entity, indicating their interest in the government contract or PPP and their qualification to submit tenders. At this stage, the public entity shall decide which of the interested suppliers are qualified to submit tenders. The qualification process is described in section 3.6. Based on the operation of the procurement system, the public entity will then be able to reduce the cost of evaluating the tenders, which may be high in the case of complex PPP tenders.<sup>192</sup>
- Second, the qualified potential suppliers will be allowed to submit tenders, which then will be evaluated by the public entity.

Article X.3 requires that the public entity shall permit a potential supplier which is not yet qualified to submit tender and be considered if there is sufficient time to complete the qualification procedures. The only limitation a public entity can make on the number of such additional suppliers is the efficient operation of the procurement system.

The selective tendering procedure seems more suitable than the open tendering procedure in relation to a PPP. The public entity can work towards more complex arrangements, like a PPP, by making the

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<sup>190</sup> Art. X.1 of the GPA.

<sup>191</sup> See S. Arrowsmith, *Government Procurement in the WTO* (The Hague: Kluwer Law International, 2003), at p. 212.

<sup>192</sup> See S. Arrowsmith, *Government Procurement in the WTO* (The Hague: Kluwer Law International, 2003), at p. 202.

qualification round and selecting the appropriate suppliers to enter into a further qualitative qualification process.

However, the question remains whether the selective tendering procedure is open to a dialogue, like the competitive dialogue, between the public entity and the potential suppliers to offer different solutions to undefined aspects in the often complex organisational, institutional, legal, and financial issues related to a PPP. The rules governing the selective procedures are silent in that respect. This will be addressed in section 3.1.5.3.

### **3.5.1.3 Limited tendering**

In the limited tendering procedure, the public entity contacts the suppliers individually. The limited tendering procedure can only be applied under certain circumstances provided that it is not used with a view to avoid maximum possible competition or in a manner violating the national treatment principle or the non-discrimination principle. The different circumstances are provided in an exhaustive list in Article XV.1 of the GPA:

- (a) in the absence of tenders in response to an open or selective tender, or when the tenders submitted have been collusive, or not in conformity with the essential requirements in the tender, or from suppliers who do not comply with the conditions for participation provided for in accordance with this Agreement, on condition, however, that the requirements of the initial tender are not substantially modified in the contract as awarded;
- (b) when, for works of art or for reasons connected with protection of exclusive rights, such as patents or copyrights, or in the absence of competition for technical reasons, the products or services can be supplied only by a particular supplier and no reasonable alternative or substitute exists;
- (c) in so far as is strictly necessary when, for reasons of extreme urgency brought about by events unforeseeable by the entity, the products or services could not be obtained in time by means of open or selective tendering procedures;



- (d) for additional deliveries by the original supplier which are intended either as parts replacement for existing supplies, or installations, or as the extension of existing supplies, services, or installations where a change of supplier would compel the entity to procure equipment or services not meeting requirements of interchangeability with already existing equipment or services;
- (e) when an entity procures prototypes or a first product or service which are developed at its request in the course of, and for, a particular contract for research, experiment, study or original development. When such contracts have been fulfilled, subsequent procurements of products or services shall be subject to Articles VII through XIV6;
- (f) when additional construction services which were not included in the initial contract but which were within the objectives of the original tender documentation have, through unforeseeable circumstances, become necessary to complete the construction services described therein, and the entity needs to award contracts for the additional construction services to the contractor carrying out the construction services concerned since the separation of the additional construction services from the initial contract would be difficult for technical or economic reasons and cause significant inconvenience to the entity. However, the total value of contracts awarded for the additional construction services may not exceed 50 per cent of the amount of the main contract;
- (g) for new construction services consisting of the repetition of similar construction services which conform to a basic project for which an initial contract was awarded in accordance with Articles VII through XIV and for which the entity has indicated in the notice of intended procurement concerning the initial construction service, that limited tendering procedures might be used in awarding contracts for such new construction services;
- (h) for products purchased on a commodity market;

- (i) for purchases made under exceptionally advantageous conditions which only arise in the very short term. This provision is intended to cover unusual disposals by firms which are not normally suppliers, or disposal of assets of businesses in liquidation or receivership. It is not intended to cover routine purchases from regular suppliers;
- (j) in the case of contracts awarded to the winner of a design contest provided that the contest has been organized in a manner which is consistent with the principles of this Agreement, notably as regards the publication, in the sense of Article IX, of an invitation to suitably qualified suppliers, to participate in such a contest which shall be judged by an independent jury with a view to design contracts being awarded to the winners.<sup>193</sup>

The limited tendering procedure has several legal reservations and, given those reservations, the limited tendering procedure will often not be applicable to PPPs. However, some aspects of the limited tendering procedure might be considered in case of re-negotiating the PPP contract. For example, it follows from Article XV(f) that a public entity is allowed to use the limited tendering procedure and thereby contact its PPP partner for additional construction services which have not been addressed in the initial contract and which, for unforeseeable reasons, have become necessary in order to complete the construction service, and where awarding a second contract to another supplier will be difficult for technical or economic reasons. However, the additional contract value must not exceed 50 per cent of the amount of the initial contract.

#### **3.5.1.4 Negotiations**

Article XIV of the GPA offers the possibility for the public entity to supplement the procedure by conducting negotiations with the private parties.<sup>194</sup> Negotiations can be seen as a tool for the public entity to

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<sup>193</sup> Art. XV.1 of the GPA

<sup>194</sup> See B. M. Hoekman and P. Mavroidis, 'Basic Elements of the Agreement on Government Procurement', in B. M. Hoekman and P. Mavroidis (eds), *Law and*

help to define the actual output based on the overall need. However, negotiation can only be applied in two occasions:

- 1) if the public entity has mentioned the intent to negotiate in the initial notice of proposed procurement; or
- 2) if the evaluation of the tenders has led to the conclusion that none of the tenders is the most advantageous one.

In the establishment of a PPP, the government procurement would then, in the first place, be required to indicate the intent to make negotiations.

The negotiation option has limitations. Article XVI.2 reads that negotiations shall *primarily be used to identify the strengths and weaknesses in tenders*. The term ‘primarily’ suggests that negotiations can concern situations other than actually identifying strengths and weaknesses in tenders.<sup>195</sup> However, such other situations can only be exceptions to the general rule and must therefore be applied carefully.<sup>196</sup> The exception seems to open up the possibility of applying negotiation during the tendering process – before the tenders have been submitted – to define the actual needs of the public entity.<sup>197</sup> However, it is up to the public entity’s state to demonstrate the conformity of its action with the exception to the general rule of identifying strengths and weaknesses in the tenders.<sup>198</sup> The exception must be seen in light of the general transparency principle and non-discrimination principle. Therefore, a public entity engaging in negotiations with a private supplier with the aim of finding organisational, institutional, financial, etc. solutions must offer persuasive reasons why it goes into such negotiations before the final tenders have been submitted. The question is whether an argumentation based on reduced transaction costs will be sufficient.

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*Policy in Public Purchasing – The WTO Agreement on Government Procurement* (Ann Arbor: The University of Michigan Press, 1997), at 17.

<sup>195</sup> See also S. Arrowsmith, *Government Procurement in the WTO* (The Hague: Kluwer Law International, 2003), at 258.

<sup>196</sup> See about interpretation of exceptions in WTO, *United States – Tax Treatment for “Foreign Sales Corporations” – Report of the Appellate Body* (14 January 2002) WT/DS108/AB/RW, para. 140.

<sup>197</sup> See S. Arrowsmith, *Government Procurement in the WTO* (The Hague: Kluwer Law International, 2003), p. 258, which suggests that a dialogue between a public entity and potential suppliers may take place before the actual tenders have been submitted.

<sup>198</sup> See from GATT practice; WTO, *Norway – Tendering Procedures on Trondheim Toll Ring Project- Report of the Panel* (28 April 1992) BISD 405/319, para. 4.5.

Another limitation on the application of negotiations to define the output needed by the public entity is provided in Article VI.4, which was described above in section 1.3.4.1.2. Article VI.4 concerns the preparation of the procurement. The limitations on the seeking of advice from potential suppliers would be nullified if the negotiation option could apply on the preparation of the procurement. Such interpretation would then not be in good faith in accordance with Article 31.1 of the Vienna Convention on the Law of Treaties. Thus the negotiation provision seems to apply only to the actual tenders, and may only take place after the tendering procedure has been initiated.

Concerning the situation where the tendering procedure has been initiated and an invitation notice has been published,<sup>199</sup> it also seems there are limitations for defining the required product in co-operation with a private supplier. If a potential supplier requests tender documentation, the public entity must, among other information, provide a complete description of the products or services required or any other requirements including: technical specifications; conformity certification to be fulfilled; necessary plans, drawings; and instructional material.<sup>200</sup> A public entity would not be able to meet that requirement if the actual product is not completely defined when the tendering procedure has been initiated.

A textual reading of Article XIV suggests that negotiations between the public entity and the private parties that are potential bidders in the set-up of the financial options, organisational and institutional structures, legal aspects, etc. is very limited under the negotiation option in Article XVI.

### **3.5.1.5 Flexibility to Engage in Dialogue?**

Given the open tendering procedure, the selective tendering procedure, the limited tendering procedure and the negotiation option in the GPA, the question remains to what extent a public entity can engage in some kind of competitive dialogue with the possible private parties to specify the potential output of the need of the public entity. The challenge is to weigh the risks of alleged discrimination and non-transparency against the reduced transaction costs and reduced uncertainties in the complex partnership between the public entity and

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<sup>199</sup> See more below in section 3.8.1

<sup>200</sup> See Art. XII.2(g) of the GPA.

the private party. As seen in chapter 4 below, the complexities of the PPP nature have led the EU to open up to allow the competitive dialogue. The competitive dialogue is a procedure between the open procedure and negotiation.<sup>201</sup> Also, the UNCITRAL Model Law suggests a ‘competitive negotiation’,<sup>202</sup> which is applicable in situations where it is not feasible for a public entity to formulate detailed specifications or identify characteristics.<sup>203</sup> The competitive dialogue allows the public entity and the potential private parties to meet and discuss and elaborate solutions to the needs of the public entity.

*On the one hand*, it can be argued that the lack of specific GPA rules about dialogue between the public entity and the private parties is not the same as a prohibition of the dialogue. On the contrary, without an explicit prohibition under WTO law, the parties to the GPA cannot be met with a claim of violation of the GPA when the Members allow the use of competitive dialogues between a public entity and private parties. As long as the GPA principles are followed, the public entity may engage in dialogues with the suppliers about the means to satisfy their needs. For example, the rules governing the selective tendering procedure are so vaguely formulated that they can encompass a competitive dialogue in the second phase after the

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<sup>201</sup> See S. Arrowsmith, ‘Implementation of the new EC procurement directives and the Alcatel ruling in England and Wales and Northern Ireland: a review of the new legislation and guidance’ (2006) *Public Procurement Law Review* 86-136, at p. 102.

<sup>202</sup> Art. 49 of the UNCITRAL Model Law. It provides:

“(1) In competitive negotiation proceedings, the procuring entity shall engage in negotiations with a sufficient number of suppliers or contractors to ensure effective competition.

(2) Any requirements, guidelines, documents, clarifications or other information relative to the negotiations that are communicated by the procuring entity to a supplier or contractor shall be communicated on an equal basis to all other suppliers or contractors engaging in negotiations with the procuring entity relative to the procurement.

(3) Negotiations between the procuring entity and a supplier or contractor shall be confidential, and, except as provided in article 11, one party to those negotiations shall not reveal to any other person any technical, price or other market information relating to the negotiations without the consent of the other party.

(4) Following completion of negotiations, the procuring entity shall request all suppliers or contractors remaining in the proceedings to submit, by a specified date, a best and final offer with respect to all aspects of their proposals. The procuring entity shall select the successful offer on the basis of such best and final offers.”

<sup>203</sup> Art. 19 of the UNCITRAL Model Law.

potential suppliers have gone through the qualification process. A dialogue between a public entity and the potential suppliers will not be in violation of WTO law as long as the competition is not limited and the non-discrimination principles are applied.<sup>204</sup> This argument finds further support by looking to the international context, such as the rules on competitive negotiation in the UNCITRAL Model Law, which guides several national systems, and the EU competitive dialogue model. Furthermore, the limitations on dialogues in the negotiation model, which was discussed above, cannot be juxtaposed to a prohibition of dialogue, as ‘negotiation’ has a different meaning to ‘dialogue’.<sup>205</sup>

*On the other hand*, it can be argued that, without an explicit procedure for dialogues under the GPA, such dialogues will be in violation of WTO law; in cases where WTO legislation has listed procedures to be followed, a procedure beyond the list will be in violation of WTO law. The GPA only offers two options for the public entity and the potential supplier to have the closeness of contact that competitive dialogue necessitates: negotiations, and the seeking of advice. Both have several limitations and the competitive dialogue must be seen in this light. Had the drafters of the GPA intended that the parties could use a procedure such as the competitive dialogue they would have written it into the GPA, as it has been written in the EU system. Any dialogue, outside the options provided in negotiation and seeking advice, will be a violation of the fundamental transparency principle if the competitive dialogue is a closed-door meeting. Such a perspective leaves little room for the public entity to apply a competitive dialogue under the selective tendering procedure. Even though a dialogue or negotiation to help identify the actual need of the public entity finds support in some international systems, they seem to be prohibited in others like the World Bank.<sup>206</sup> Therefore, it

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<sup>204</sup> See S. Arrowsmith, *Government Procurement in the WTO* (The Hague: Kluwer Law International, 2003), at 265.

<sup>205</sup> In Black’s Law Dictionary, ‘negotiation’ is defined as ‘[t]he deliberation, discussion or conference upon the terms of a proposed agreement; the act of settling or arranging the terms and conditions of a bargain, sale, or other business transaction’. The terms of the contract then seem to be an essential element of the definition of negotiation. The dialogue on the other hand is applied to help define and shape the needs of the public entity.

<sup>206</sup> The World Bank has issued procurement guidelines in the *Guidelines Procurement under IBRD Loans and IDA Credits*, which apply where a State is borrowing money for a specific project. The Guidelines Procurement provides that a two-stage bidding is allowed for complex contracts, where the first stage

cannot be said that there is an international consensus on the application of such dialogue or negotiation, and, as such, the GPA cannot be interpreted in such manner.

The lack of textual support of competitive dialogue leads to uncertainty about the conformity of that procedure with the GPA. Such uncertainty was also reflected in the EU system before the introduction of the competitive dialogue provision in the Public Sector Directive in 2004. There were concerns whether the public entity could enter into dialogues with the private party in order to establish a PPP under the procurement rules at that time.<sup>207</sup> After the introduction of the competitive dialogue provision in the Public Sector Directive, several legal concerns have been raised about of the lack of clarity in the scope of application of competitive dialogue.<sup>208</sup>

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concerns the submission of unpriced technical proposals by the potential suppliers, on which the public entity may base its adjustment of its tender documentation; see Art. 2.6. Negotiations only seem to be an option where all tenders have been rejected; see Art. 2.61-2.64. Besides, the World Bank has issued *Guidelines: Selection and Employment of Consultants by World Bank Borrowers*. Such consultants may be used to define the output based on the need of a public entity and can therefore be relevant to PPPs. However, such consultants are ‘disqualified from subsequently providing goods, works or services (other than consulting services covered by these Guidelines) resulting from or directly related to the firm’s consulting services for such preparation or implementation’; see Art. 1.9(a). The World Bank makes a clear distinction between advisory services, for example to identify specific projects a country can carry out in order to achieve a certain goal, and ‘services in which physical aspects of the activity predominate (for example, construction of works, manufacture of goods, operation and maintenance of facilities or plant, surveys, exploratory drilling, aerial photography, satellite imagery, and services contracted on the basis of performance of measurable physical output)’; see Art. 1.7. The latter type of service is regulated in the Guideline Procurement. This distinction further indicates that technical advice on preparing the procurement is not allowed under the World Bank framework. See also E. Nwogwugwu, ‘Towards the harmonisation of international procurement policies and practices’ (2005) *Public Procurement Law Review* 131-152, at p. 137.

<sup>207</sup> For discussion on this, see S. Arrowsmith, ‘Public Private Partnerships and the European Procurement Rules: EU Policies in Conflict?’ (2000) 37 *Common Market Law Review* 709-737.

<sup>208</sup> See, for instance, S. Treumer, ‘The Field of Application of Competitive Dialogue’ (2006) *Public Procurement Law Review* 307-315; and also S. Treumer, ‘Competitive Dialogue’ (2004) *Public Procurement Law Review* 178-186.

So far, the negotiators have provisionally agreed on a revised version of the GPA.<sup>209</sup> The revised version is also silent about PPPs and the possibility to engage in a dialogue outside of the rules on technical specification and negotiation. However, one notable change concerns the negotiation procedure. In the revised GPA, the requirement in the existing GPA that negotiations shall primarily identify strengths and weaknesses in the tender has been deleted. Negotiations are not limited to concern the tender but may also concern other matters, e.g. different solutions for the institutional and financial framework of a PPP. Those changes seem to offer more flexibility in the GPA; through their implementation, the rules in the GPA will, perhaps, be better suited for PPPs than the existing GPA.

### **3.6 Qualification of Suppliers**

Due to the complexity of PPPs, the public entity will have requirements for the suppliers, who will make a bid on the PPP contract. The GPA allows public entities to set up conditions for suppliers to qualify for the tendering procedure.

The public entity may use a permanent list of qualified suppliers which are automatically qualified to participate in the tendering procedure. In the selective tendering procedures, the public entity may select potential suppliers from such a list to submit tender. Any selection shall allow for equitable opportunities for the suppliers on the lists.<sup>210</sup> In line with the transparency principle, entities maintaining such a list are required to publish annually a notice of:

- a) the enumeration of the lists maintained, including their headings, in relation to the products or services or categories of products or services to be procured through the lists; b) the conditions to be fulfilled by suppliers with a view to their inscription on those lists and the methods according to which each of those conditions will be verified by the entity concerned; and c) the period of validity of the lists, and the formalities for their renewal.<sup>211</sup>

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<sup>209</sup> For more details about the revised version of the GPA, see: R. D. Anderson, 'Reviewing the WTO Agreement on Government Procurement: Progress to Date and Ongoing Negotiations' (2007) *Public Procurement Law Review* 255-273.

<sup>210</sup> Art. X.2 of the GPA.

<sup>211</sup> Art. IX.9 of the GPA.



The notice shall be published in one of the media each GPA Party has written into its Appendix III.

The following part concerns the conditions that the government entities may use in the qualification process.

### **3.6.1 Conditions**

Article VIII(b) of the GPA states that the requirements for the suppliers to participate in the procedure must not go beyond conditions which are essential to ensure the supplier's capability to fulfil the PPP contract. The GPA does not define or clarify the essential conditions a public entity can impose on suppliers in the expectations of them to fulfil a PPP contract, but the conditions must be related to the performance of the contract.<sup>212</sup>

The conditions and the verification of the suppliers' qualifications must be in line with the non-discrimination and national treatment principle, e.g. a public entity must not make fewer requirements for a domestic supplier compared to the requirements for suppliers from other GPA Parties.

The conditions may be – but are not limited to:

- Financial capacity: the public entity may require financial guarantees from the supplier to participate in the process. In particular for PPPs, where the private supplier will often be the economic investor in building the object, such as infrastructure, the public entity needs financial guarantees from the private supplier to ensure it has the financial capacity to fulfil the possible PPP contract;
- Commercial capacity: the public entity may need certainty about the commercial qualifications of the supplier. For example, the supplier might be operating a road-pricing system, with requirements on the commercial capacity to advertise;
- Technical capacity: the public entity needs information about the technical qualifications of the supplier in order to ensure

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<sup>212</sup> See also S. Arrowsmith, *Government Procurement in the WTO* (The Hague: Kluwer Law International, 2003), p. 225 and; C. Pitschas and H. J. Priess, 'Secondary policy criteria and their compatibility with E.C. and WTO procurement law. The case of the German Scientology Declaration' (2000) *Public Procurement Law Review* 171-195, at 188.

that the supplier can fulfil for example the building of a school, bridge, road system etc.

The supplier's capacity in the above-mentioned areas shall be evaluated on 1) the supplier's global business activity and 2) the supplier's activity in the territory of the public entity making the procurement.<sup>213</sup>

The text of Article VIII(b) is not limited to the above-mentioned conditions, but what other conditions a public entity may include is unclear. The general principles, such as non-discrimination, must obviously be followed, and in the selection of suppliers a public entity may not impose, seek or consider offsets.<sup>214</sup> From the text of Article VIII(b), the conditions for the suppliers to qualify must be *essential to fulfil the contract*. The question is whether it can be an essential condition for a contract that the potential supplier has a record of acting in accordance with, for example, environmental standards or human rights if the PPP contract concerns the establishment of a communication network, or whether the conditions can only relate to the material aspect of the contract, like the potential supplier's capacity to establish the communication network. In such a scenario, a human right condition could relate to fair wages to the workers, which may not be an essential condition to establish the communication network. In *US – Procurement*, the EC and Japan questioned the US practice of rejecting companies that were doing business with Myanmar (Burma) from qualifying to submit bids on public procurements. The EC and Japan claimed that the US practice violated Article X of the GPA, as the qualification of suppliers was based on political rather than economic considerations.<sup>215</sup> The EC and Japan requested the Panel to suspend the Panel proceedings and the case later expired. The question of whether the qualification criteria are limited to economic considerations was not clarified in the Dispute Settlement Body. Article X does not mention that a public entity may only apply economic considerations in its selection process of qualifying suppliers to make bids, but only that the procedure must be fair and non-discriminatory. However, the rejection of suppliers who are in business with another WTO Member which apparently violates

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<sup>213</sup> Art. VIII(b).

<sup>214</sup> Art. XVI.1 of the GPA

<sup>215</sup> WTO, *Request for Consultations by the European Communities* (26 June 1997) WT/DS88/1, GPA/D2/1; and WTO, *Request for Consultations by Japan*, (21 July 1997) WT/DS95/1, GPA/D3/1.

international human rights<sup>216</sup> will probably be a violation of the GPA, unless the public entity can demonstrate that human rights are essential to fulfil the contract in question, which apparently was not the case. If Article VIII(b) does not allow a public entity to include human rights or environmental conditions as essential to the contract performance, it must be asked whether the public entity can make it part of the contract that human rights or environmental standards are followed, thereby including human rights or environmental conditions as essential to the contract performance.

However, the GPA allows the public entity to reject a supplier from qualifying on grounds other than those solely contract-related. Article VIII(h) of the GPA provides that the public entity can at any time exclude a supplier from the process for example if the supplier goes bankrupt or the supplier has submitted false declarations.<sup>217</sup> Sue Arrowsmith has suggested a broader interpretation of Article VIII(h), which would include an examination of the potential suppliers' integrity. From that perspective, a public entity would be allowed to disregard potential suppliers with a criminal record or other unethical elements.<sup>218</sup> In this respect, it is open to discussion whether a public entity can reject a supplier which has a record of violating international conventions on fair wages or equal payment.

The question about the conditions to select the suppliers cannot easily be answered, and it must be a case-to-case discussion whether the conditions on the suppliers are legitimate or not. What is clear from the text though is that the conditions are not limited to only concern economic considerations; the conditions must be essential to perform the contract. The question is whether human rights, environmental aspects or other non-economic policies in relation to the potential supplier are essential for the supplier to perform the contract concerning the PPP.<sup>219</sup>

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<sup>216</sup> Myanmar is a WTO Member.

<sup>217</sup> Art. VIII(h) of the GPA.

<sup>218</sup> S. Arrowsmith, *Government Procurement in the WTO* (The Hague: Kluwer Law International, 2003), pp. 226-228. See also C. McCrudden, *Buying Social Justice – Equality, Government Procurement, & Legal Change* (Oxford: Oxford University Press, 2007), at 484-486. For a different view, see C. Pitschas and H. J. Priess, 'Secondary policy criteria and their compatibility with E.C. and WTO procurement law. The case of the German Scientology Declaration' (2000) *Public Procurement Law Review* 171-195, at 188-189.

<sup>219</sup> See also S. Arrowsmith, *Government Procurement in the WTO* (The Hague: Kluwer Law International, 2003), pp. 337-342.

Three aspects must be noted. Firstly, in the awarding phase there seems to be more options for a public entity to include other factors that are not attached to the actual contract performance. Even though a public entity may not disregard a supplier in the procedure, if there is an interest in including factors like human rights, a later phase in the procedure will allow the public entity to include such factors. Secondly, the GPA allows exceptions for aspects concerning human and plant life, etc. which may be applicable; see more in section 1.3.7. Thirdly, a GPA Party might be bound by other international obligations that might interfere with the GPA. That could, for example, be the human right concerns. In that case, it can be argued that the GPA should be interpreted in a manner not to conflict with the other international treaty due to the principle of harmonious treaty interpretation. In particular, if the other international treaty is binding on both the state of the public entity and the state of the interested suppliers, it can be argued that the conditions on the suppliers should reflect the requirements of the other international treaty.<sup>220</sup>

### **3.6.2 Qualification process**

The public entity must not use the process of, and time required in, qualifying suppliers to keep suppliers from other GPA Parties from being considered for the intended procurement or to be kept out of a supplier list. If a potential supplier fulfils the conditions, the public entity must recognise that supplier as qualified to participate in the tendering process. Suppliers which have not yet qualified must also be considered by the public entity if there is sufficient time to complete the qualification process.<sup>221</sup> The public entity must advise the supplier about its decision.<sup>222</sup>

If the public entity applies permanent lists of qualified suppliers, it shall ensure that other suppliers may apply for qualification to that list at any time.<sup>223</sup> If a supplier is terminated or removed from the list, the public entity must inform that supplier.<sup>224</sup>

The public entity must publish the conditions on suppliers for participating in the tender procedures in adequate time so the suppliers

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<sup>220</sup> See more below in section 3.7.

<sup>221</sup> Art. VIII(c) of the GPA.

<sup>222</sup> Art. VIII(f) of the GPA.

<sup>223</sup> Art. VIII(d) of the GPA.

<sup>224</sup> Art. VIII(f) of the GPA.

can both initiate and complete the qualification procedure.<sup>225</sup> If a supplier that is not yet qualified requests to participate in an intended procurement after the public notice has been published, the public entity must promptly start qualification procedures for that supplier.<sup>226</sup>

### 3.7 Awarding Criteria

Article XIII.4 of the GPA concerns the award of the contract. A supplier can be considered for the award if the tender conforms to the requirements in the notice or tender documentation. The award goes to the supplier who is capable of undertaking the contract and whose tender is either the *lowest tender* or the *most advantageous*, i.e. the tender which, in terms of the evaluation criteria set forth in the notices or tender documentation, is determined to be the most advantageous.

The lowest tender is the tender with the lowest price. An award based on the lowest tender is the most transparent. However, basing the award on the lowest tender does not give the public entity any room to include qualitative aspects in the award determination, and it may therefore not be suitable for a PPP.

The most advantageous tender based on the criteria in the tender documentation is the tender which, for example, gets the highest score in the evaluation process. Basing the award on the most advantageous tender allows the public entity to include qualitative measures by setting up qualitative criteria that the suppliers must fulfil in order to get the contract;<sup>227</sup> therefore it seems more suitable for PPPs.

If the award is based on the most advantageous tender, the question is what criteria a public entity can apply to evaluate the different tenders and whether such evaluation criteria can be non-economic criteria. The aim of the GPA highlights the economic goals of achieving liberalisation and expanding the world trade. Furthermore, the GPA emphasises competition in the procedures. For example: seeking advice from potential suppliers must not have the effect of precluding competition; the selective tendering procedure must be made in a manner to ensure optimum effective international competition; the public entity must not provide any supplier

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<sup>225</sup> Art. VIII(a) of the GPA.

<sup>226</sup> Art. VIII(e) of the GPA.

<sup>227</sup> See S. Arrowsmith, *Government Procurement in the WTO* (The Hague: Kluwer Law International, 2003), pp. 250-254.

information in a manner that would have the effect of precluding competition etc.

Looking into the context, Article XII.2(h) of the GPA provides that a public entity must give tender documentation to the potential suppliers, and that tender documentation shall contain the criteria for awarding the contract,

*including any factors other than price* that are to be considered in the evaluation of tenders and the cost elements to be included in evaluating tender prices, such as transport, insurance and inspection costs, and in the case of products or services of other Parties, customs duties and other import charges, taxes and currency of payment.<sup>228</sup>

Criteria other than economic ones may be included by the public entity to evaluate the different tenders.<sup>229</sup> Therefore, a public entity may require that the private partner in the PPP follows some international labour standards, human rights standards, environmental standards, etc.

The criteria, however, must comply with the non-discrimination principle, national treatment principle and transparency principles of the GPA, as well as the requirements about technical specifications in Article VI. Furthermore, the prohibition of offsets must be followed, which rules out the possibility for the public entity to require some domestic social policies to be carried out, for example, the use of local women or men to work for the PPP,<sup>230</sup> although there may be some exceptions if the public entity is from a developing or least-developed country; see section 1.3.2.3.

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<sup>228</sup> Art. XII.2(h)

<sup>229</sup> See also S. Arrowsmith, *Government Procurement in the WTO* (The Hague: Kluwer Law International, 2003), at 343-344 and; C. McCrudden, *Buying Social Justice – Equality, Government Procurement, & Legal Change* (Oxford: Oxford University Press, 2007), at 487. See, for a different view, C. Pitschas and H. J. Priess, ‘Secondary policy criteria and their compatibility with E.C. and WTO procurement law. The case of the German Scientology Declaration’ (2000) *Public Procurement Law Review* 171-195, at 190; and A. Kovacs, ‘The Global Procurement Harmonisation Initiative’ (2004) *Public Procurement Law Review* 15-38, at p. 18.

<sup>230</sup> See also M. Dischendorfer, ‘The Existence and Development of Multilateral Rules on Government Procurement under the Framework of the WTO’ (2000) *Public Procurement Law Review* 1-38, at 26-27.

Those limitations affect the criteria that a public entity may apply. For example, by including environmental standards, the public entity might give a supplier from country A an advantage over a supplier from country B if the supplier in country A follows country A's strict environmental standards, but country B has no such standards, and the supplier in country B has not implemented a restrictive environmental production method which will be costly to implement. In such situations, the supplier from country A will be in a more advantageous position than the producer in country B. The question will then be whether the high standard requirement is, in fact, indirect discrimination to favour the suppliers from country A. If a public entity includes criteria that are in violation of the GPA, there is the possibility that such criteria can be exempted in accordance with Article XXIII of the GPA.

Therefore, the test will first be whether the factor is in accordance with the GPA. In this respect it can be argued that if those GPA parties that are relevant in the actual procedure have all signed an international treaty, for example concerning the environment, the interpretation of the GPA should use the international treaty as a context. That could lead to an interpretation where the GPA is not violated even though environmental concerns are included in the awarding phase.<sup>231</sup> For example, if the international environmental treaty requires a special process in producing products, which potentially would put some of the GPA Parties in a better position than other GPA Parties, there would not be a violation of the non-discrimination principle, as all the relevant GPA Parties have signed that international environmental treaty. The situation would be different, however, if some of the GPA Parties had not signed the international environmental treaty. In that case it can be argued that the GPA would be violated if the environmental criteria would leave the non-signatories in a worse position than the other GPA parties.

If the criterion is a violation of the GPA, the next step is to evaluate whether such criterion can still be applied in accordance with the exceptions written into Article XXIII of the GPA.<sup>232</sup>

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<sup>231</sup> This follows from the Vienna Convention on the Law of Treaties Art. 31.3(c).

<sup>232</sup> See, in relation to Art. XX of GATT 1994, WTO, *United States – Standards for Reformulated and Conventional Gasoline Report of the Appellate Body* (29 April 1996) WT/DS2/AB/R, p. 22. See also: GATS Art. XIV; and WTO, *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services – Report of the Appellate Body* (7 April 2005) WT/DS285/AB/R, para. 339.

Article XXIII.1 of the GPA concerns exceptions based on security interest. If the PPP concerns *essential security interest*, the public entity may exempt the government procurement procedure from the GPA if it is necessary and the essential security interest is related to either arms, ammunition or war materials, or if the security interest is related to procurement indispensable for national security or for national defence purposes. There are no requirements concerning non-discrimination or limitations on the restrictions of international trade. Hence, if a public entity can demonstrate that the procurement concerns an essential security interest concerning one of the mentioned areas, and a violation of the GPA is necessary to protect those interests, then there is a legitimate basis for such exemption.<sup>233</sup>

Besides the protection of essential security interests, the GPA exempts other areas, although there are stricter requirements. Article XXIII.2 of the GPA provides:

Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent any Party from imposing or enforcing measures: *necessary to protect public morals, order or safety, human, animal or plant life or health or intellectual property; or relating to the products or services of handicapped persons, of philanthropic institutions or of prison labour.* (emphasis added).

Article XXIII.2 has a similar structure and requirements for imposing the exceptions as Article XX of GATT 1994; and the interpretation of that provision by Panels and Appellate Body might be useful in relation to Article XXIII.2 of the GPA.<sup>234</sup> In *US – Gasoline*, the Appellate Body stated that the first step in applying Article XX of GATT 1994 is to make a provisional justification of the

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<sup>233</sup> See also C. Pitschas, 'World Trade Organisation/United States: award of prime contracts for infrastructure reconstruction in Iraq - an assessment under the WTO Agreement on Government Procurement' (2004) *Public Procurement Law Review* NA85-89, at 87.

<sup>234</sup> See also C. McCrudden, *Buying Social Justice – Equality, Government Procurement, & Legal Change* (Oxford: Oxford University Press, 2007), at 491.



measure in question, which is to determine whether the actual policy is listed in Article XX and whether the measure is necessary to reach the policy. The second step is to evaluate the measure under the introduction part of Article XX of GATT 1994.<sup>235</sup> If the public entity fulfils the first-step requirement, the public entity must evaluate the *chapeau* of Article XXIII.2 in the second step. In *Brazil — Retreaded Tyres*, The Appellate Body made a statement about the evaluation of the *chapeau* of Article XX of GATT 1994, which can be useful in the context of the GPA:

The *chapeau*'s requirements are two-fold. First, a measure provisionally justified under one of the paragraphs of Article XX must not be applied in a manner that would constitute "arbitrary or unjustifiable discrimination" between countries where the same conditions prevail. Secondly, this measure must not be applied in a manner that would constitute "a disguised restriction on international trade".<sup>236</sup>

In relation to Article XXIII.2 of the GPA, the public entity must:

- 1) Evaluate whether the secondary policy is *necessary* to protect one of the listed areas: protection of public morals, orders or safety; protection of human, animal or plant life or health; protection of intellectual property rights; relating to products or services of handicapped persons; relating to products or services of philanthropic institutions; or relating to product or services of prison labour. If the requirements under step 1 are met, the public entity must then move on to step 2.
- 2) The public entity must ensure that the measures are not applied in a manner that will constitute arbitrary or unjustifiable discrimination towards private suppliers from countries with similar conditions. For example, if two countries are using the same protection for plant life, the public entity from the one

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<sup>235</sup> WTO, *United States – Standards for Reformulated and Conventional Gasoline Report of the Appellate Body* (29 April 1996) WT/DS2/AB/R, p. 22. See also WTO, *United States – Import Prohibition of Certain Shrimp and Shrimp Products – Report of the Appellate Body* (12 October 1998) WT/DS58/AB/R, para. 118-120. See more about the test under Art. XX of GATT 1994 in L. Nielsen, *The WTO, Animals and PPMs* (Leiden: Martinus Nijhoff Publishers, 2007), pp. 156-176.

<sup>236</sup> WTO, *Brazil – Measures Affecting Imports of Retreaded Tyres- Report of the Appellate Body* (3 December 2007) WT/DS332/AB/R, para. 215.

country cannot impose standards which will favour the private suppliers from the same country over suppliers from the countries with the same standards. However, if the standards in the countries are not the same, the public entity may require – and thereby indirectly discriminate – that suppliers from countries with lower standards will not be accepted unless the suppliers apply the similar standards as the country of the public entity. For example, if a country has signed a specific multilateral environmental agreement, that agreement will obligate the country. It can be argued that such a commitment is a justifiable reason for the country to discriminate, even in a situation where the other GPA Party has not signed the other international treaty.<sup>237</sup> Furthermore, the measures may not be applied in a manner that could constitute a disguised restriction on international trade.

The following part discusses some policies which a public entity may include in the awarding criteria. The focus here is on human rights and environmental issues.

### **3.7.1 Human Rights**

Human rights are often used in the context of protection of citizens against the state. Even though human rights often concern citizens rights versus the state, several of the human rights guarantees are also relevant in the relation between the employee and the employer; the private buyer and the private supplier; and, in this case, a public entity and the product supplied by the potential supplier to the PPP. The question here is whether it is legitimate or even a requirement under WTO law for a public entity to require that the supplier follows human rights principles in the production, or whether the public entity can require that the private supplier uses materials which have been produced by others following human right principles. Human rights were one reason for the US rejection of suppliers doing business with Myanmar (Burma), as there is evidence of several human rights violations in Myanmar (Burma). As written above, the case never proceeded through a Panel. The question about the rejection of

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<sup>237</sup> G. Marceau, ‘Conflict of Norms and Conflict of Jurisdictions – The Relationship between the WTO Agreement and MEAs and other Treaties’ (2001) 35 (6) *Journal of World Trade* 1081-1131, at p. 99.

suppliers which are in business with a WTO Member that violates human rights, therefore, remains open.

Neither in the multilateral WTO context, nor in the GPA are there any requirements on the public entity to take human rights into account in the procurement process. Even though human rights are not explicitly written into the GPA or the WTO agreements, some of the human rights values, such as non-discrimination and the right to water, are protected in the WTO framework.<sup>238</sup> Such aspects must be taken into account by the public entity. However, even though the WTO agreements share some similarities with human right treaties, there are also clear differences, e.g. the WTO aim of enhancing the economic environment without taking notice of human rights.<sup>239</sup> Furthermore, there is no definition of Human Rights in the WTO framework, and therefore the balance between the economic promotion and human rights cannot be derived from such a definition. No guidance can be found in Panel and Appellate Body practice, as they have, so far, been able to avoid the question of human rights in WTO law.

Even though the WTO does not impose any human rights requirements on the public entities, the WTO and the GPA cannot be seen in isolation from public international law. Public international law has several human rights safeguards in international treaties and peremptory norms in the principle of *jus cogens*. For example, slavery is forbidden, and the imposition of such a requirement on the suppliers will be legitimate under public international law. Several GPA Parties have ratified international human rights treaties, and the lack of clear guidance in the GPA opens the possibility to fill in the gaps of the GPA with the human rights concerns.

Including human rights as a criterion in the evaluation of the tenders cannot be a violation of the GPA if the human rights have a legitimate basis in another international treaty that the state of the public entity and the states of the potential suppliers are bound by, or *jus cogens*.<sup>240</sup> In accordance with the principle of harmonious

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<sup>238</sup> E. U. Petersmann, 'Human Rights and International Trade Law – Defining and Connecting the Two Fields', in T. Cottier, J. Pauwelyn, and E. Bürgi (eds.), *Human Rights and International Trade* (Oxford: Oxford University Press, 2005), 29-94, at 33.

<sup>239</sup> H. Lim, 'Trade and Human Rights What's at Issue?' (2001) 35 *Journal of World Trade* 275–300, at 278-280.

<sup>240</sup> See J. Pauwelyn, 'Human Rights in WTO Dispute Settlement', in T. Cottier, J. Pauwelyn, and E. Bürgi (eds.), *Human Rights and International Trade* (Oxford:

interpretation,<sup>241</sup> it must be assumed that the GPA will not be interpreted in a manner that would conflict with those international treaties if a public entity, for example, requires that the product from the supplier to the PPP is produced in accordance with human rights concerning working hours.

However, should the situation be that the interpretation of the GPA cannot lead to conclusions that conflict with the human rights requirements under the other international treaty, the GPA allows exceptions from the GPA in order to protect public morals; human lives and safety; and measures relating to products or services of handicapped people. As mentioned above, there are several limitations which must be applied, including the necessity test and that the measures are not applied in a manner that will constitute arbitrary or unjustifiable discrimination. In this respect, it must be assumed that if a state is party to an international human right treaty, and if failure to apply the human right measure as a criterion to award the tender will be a violation of the human right treaty, the necessity test will be fulfilled and the possible discrimination justified.

On an international level, there are several international treaties concerning the protection of human rights; therefore, only a few will be mentioned here. In a UN context, it follows from Article 55 of the Charter of the United Nations (UN) that the UN shall promote universal respect for and observance of human rights, and it is written into the preamble that the faith in human rights is reaffirmed. Within the UN framework, the UN provides several human right treaties that are binding on states.<sup>242</sup> For example, the Universal Declaration of Human Rights (UDHR) concerns principles of human rights. The Declaration is not a binding treaty, but it may, debatably, have achieved status as international customary law.<sup>243</sup> The UDHR

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Oxford University Press, 2005) 205-231, and; S. Arrowsmith, *Government Procurement in the WTO* (The Hague: Kluwer Law International, 2003), at 356.

<sup>241</sup> See Art. 31.3(c) of the Vienna Convention on the Law of Treaties. See also I. Van Damme, *Treaty Interpretation by the WTO Appellate Body* (Oxford: Oxford University Press, 2009), pp. 357-359.

<sup>242</sup> See for an overview the Office of United Nations High Commissioner of Human Rights: <<http://www2.ohchr.org/english/law/>> accessed 30 November

<sup>243</sup> See, for example, H. Hannum, 'The Status of the Universal Declaration of Human Rights in National and International Law' (1995/6) *25 Georgia Journal of International and Comparative Law* 287-397; and M. Darrow and L. Arbour, 'The pillar of Glass: Human Rights in the Development Operations of the United Nations' (2009) *103 American Journal of International Law* 446-501, at 470.

provides, for example, that slavery is forbidden;<sup>244</sup> that everyone has a right to work under just and favourable conditions of work; that no discrimination must take place at work; and the right to form or join trade unions.<sup>245</sup> The International Covenant on Civil and Political Rights (ICCPR) is a binding treaty with 166 parties.<sup>246</sup> The ICCPR includes provisions concerning the prohibition of slavery and slave-trade, including forced labour.<sup>247</sup> The International Covenant on Economic, Social and Cultural Rights (ICESCR) is a binding treaty with 160 parties.<sup>248</sup> Generally, the ICESCR gives the right to self-determination for individuals to freely chose their political status and pursue their economic, social and cultural development.<sup>249</sup> The ICESCR provides that wages must be fair and, in particular, women are guaranteed working conditions which are not inferior to those enjoyed by men; that there is equal payment for equal work; and also that the working conditions must be healthy and safe.<sup>250</sup>

It is important to bear in mind that the treaties are only binding on the states, and not the private suppliers. Attempts have been made to make a treaty with binding human rights principles on Multi-National Enterprises; however, with no consensus among states, no Treaty has been concluded.<sup>251</sup> Generally, public international law is not directly applicable on private companies or citizens, and it is debated whether public international law ought to be extended to cover the actions by Multi-National Enterprises.<sup>252</sup> Instead, States are required to protect human rights. It can be argued that the obligations on states to protect human rights must also be reflected in the actual PPP. The State

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<sup>244</sup> Art. 4 of the UDHR.

<sup>245</sup> Art. 23 of the UDHR.

<sup>246</sup> Some countries have signed the ICCPR but not ratified it; for example China, Laos and Pakistan. Others, e.g. Malaysia, Burma, Saudi Arabia and Singapore, have not signed the ICCPR.

<sup>247</sup> Art. 8 of the ICCPR.

<sup>248</sup> Some countries, e.g. the US, have signed the ICESCR but not ratified it.

<sup>249</sup> Art. 1 of the ICESCR.

<sup>250</sup> Art. 7 of the ICESCR.

<sup>251</sup> UNESC 'Norms on the Responsibilities of Transnational Corporations and other Business Enterprises with Regard to Human Rights' (26 August 2003) E/CN.4/Sub.2/2003/12/Rev.2.

<sup>252</sup> See, for example: J. H. Knox, 'Horizontal Human Rights Law' (2008) 102 *American Journal of International Law* 1-47, concerning the risks of private duties under public international law. See for a different approach; D. Kinley and J. Nolan, 'Trading and Aiding Human Rights Corporations in the Global Economy' (2007) 25 (4) *Nordisk Tidsskrift for Menneskerettigheter* 353-377.

engaged in a PPP would have to terminate the PPP if the private party was supplying its services with slave labour.

Also, the WTO Ministerial Conference recognises human rights principles. In 1996, The WTO Ministerial Declaration from Singapore renewed WTO's commitments to observe the internationally recognised core labour standards which are set and dealt with by the International Labour Organization (ILO).<sup>253</sup> Those standards are not binding in a WTO context, but, as mentioned above, those treaties may have an impact on WTO law given that the WTO agreements might be interpreted in a manner that would not conflict with other international law treaties.

Within the ILO context, binding standards have been made. For example, forced labour is prohibited,<sup>254</sup> discrimination is prohibited;<sup>255</sup> and the worst forms of child labour, like slavery, prostitution, drug trafficking, or work harming the health, safety, or morals of the child are prohibited.<sup>256</sup> Furthermore, the ILO also governs wages and labour clauses in public contracts, which can be important for government entities establishing PPPs.<sup>257</sup> Some countries, such as China and the US, are, however, reluctant to ratify those standards. The problem is whether some of the aspects of the standards also reflect customary rules of international law, like the prohibition of slavery under the principle of *jus cogens*, and therefore will be binding upon those states which do not ratify the standards.

Even though some ILO standards might be seen as context to the GPA, the ILO standards do not impose obligations on the companies but only the states. However, states that are parties to the conventions must fulfil their ILO commitments. Therefore, a public entity must require that the potential suppliers to the PPP fulfil the standards under which the state of the public entity is committed. The public entity can make such requirements as a part of the awarding criteria

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<sup>253</sup> WTO, *Singapore Ministerial Declaration adopted on 13 December 1996* (18 December 1996) WT/MIN(96)/DEC, para. 4.

<sup>254</sup> Convention concerning Forced or Compulsory Labour, C29, adopted on 28 June 1930; and Convention on the Abolition of Forced Labour, C105, adopted 25 June 1957.

<sup>255</sup> Convention concerning Discrimination in Respect of Employment and Occupation, C111, adopted 25 June 1958.

<sup>256</sup> Convention concerning the Prohibition and Immediate Action for the Elimination of the Worst Forms of Child Labour, C182, adopted 17 June 1999.

<sup>257</sup> Labour Clauses (Public Contracts) Convention, C94, adopted 29 June 1949. See also H. K. Nielsen, 'Public Procurement and International Labour Standards' (1995) *Public Procurement Law Review* 94-101.

without coming in conflict with the GPA, which in that case must be interpreted in harmony with the ILO requirements of the state..

Even though the GPA may be interpreted in a manner that allows, or even requires, the human rights concern, several issues are then brought to the forefront. The definitions of human rights and the possible hierarchy between different human rights are not clear, although *jus cogens* is the highest ranking norm.<sup>258</sup> However, the principle of *jus cogens* lacks precision in its definition and content.<sup>259</sup> Some human rights are core principles under *jus cogens*, thus ranking higher than the GPA. Other human rights values are not. The question is how to interpret the GPA in cases where the interpretation of the GPA may lead to conflict with such human rights.<sup>260</sup> Another question concerns the extra-territorial consequences of applying a human right criterion based on an international treaty which is not ratified by all GPA Parties. For example, several of the ILO conventions have not been ratified by the US. The question is, therefore, whether a public entity which requires the supplier to only use products from countries where the workers have such protection can be justified under the GPA. As mentioned above, it can be argued that by applying the exceptions under the GPA, a public entity can apply such standards that are not applied in the State of the potential supplier. However, the question has not been resolved in practice and, therefore, needs some clarification.

### 3.7.2 Environment

The aim of the WTO to open up the global market for cross-border sales might be in conflict with national measures protecting the environment. For example, a WTO member might have a special focus on biodiversity and will not allow the sale – and, indirectly, the import – of products which, in the process of production, emit wastewater into rivers, lakes, etc. and harm wildlife, etc. unless the

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<sup>258</sup> See D. Ingram, *Law – Key Concepts in Philosophy* (London: Continuum International Publishing Group, 2006), 27.

<sup>259</sup> D. Shelton, ‘Normative Hierarchy in International Law’ (2006) 100 *American Journal of International Law* 291-323.

<sup>260</sup> See, for example, E. U. Petersmann, ‘Human Rights and International Trade Law – Defining and Connecting the Two Fields’, in T. Cottier, J. Pauwelyn, and E. Bürgi (eds.), *Human Rights and International Trade* (Oxford: Oxford University Press, 2005), 29-94, at 33.

production uses certain filters for the wastewater. Such a national measure will also bind the public entity, which is about to establish a PPP. The public entity might require that its private partner fulfils the same conditions. However, such a requirement can be discriminatory if some potential suppliers depend on products from producers in states without such standards; and the requirements can be a quantitative restriction to trade in violation of general WTO principles and the GPA.

The WTO does not provide an agreement specifically dealing with the protection of the environment, although several WTO agreements include provisions that are relevant to environmental issues.<sup>261</sup> The WTO has established the Committee on Trade and Environment, which, among other things, looks into the relationship between trade and the environment in order to promote sustainable development. Furthermore, there have been some cases concerning WTO law and the environment in the Dispute Settlement System, and in *Brazil – Retreaded Tyres*, the Appellate Body stated that it is aware that a tension exists between the free trade ideal and environmental protection.<sup>262</sup>

The GPA is, to a limited extent, opening up for environmental perspectives which may be included as factors in the awarding phase. As already mentioned, the public entity can apply criteria other than economic criteria to evaluate the potential tenders from different suppliers. Environmental criteria can be a requirement of the public entity without violating the GPA if the GPA principles of non-discrimination, national treatment, transparency, etc. are followed. A public entity may therefore require that the supplier to the PPP fulfils environmental criteria.<sup>263</sup> Such criteria find further legitimacy if both the state of a public entity and the state of the potential suppliers are parties to a multilateral environmental agreement, as it can be argued that the GPA must be interpreted in that light. There exists a great

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<sup>261</sup> For example, the Agreement on Technical Barriers to Trade provides that the protection of the environment is a legitimate factor in imposing obstacles to trade in goods if the trade restriction does not go beyond what is necessary, and the evaluation of the risk to harm the environment is based on available scientific and technical information; related processing technology; or intended end-uses of products; see Art. 2.2 of the Agreement on Technical Barriers to Trade.

<sup>262</sup> WTO, *Brazil – Measures Affecting Imports of Retreaded Tyres- Report of the Appellate Body* (3 December 2007) WT/DS332/AB/R, para. 210.

<sup>263</sup> See also R. H. Weber, 'Development promotion as a secondary policy in public procurement' (2009) *Public Procurement Law Review* 184-200, at 188.



number of multilateral environmental agreements concerning, for example, the atmosphere,<sup>264</sup> biodiversity,<sup>265</sup> chemicals and wastes,<sup>266</sup> ocean, seas and water,<sup>267</sup> land,<sup>268</sup> and other areas.<sup>269</sup>

The question is whether the argument of including multilateral environmental treaties as context to the interpretation of the GPA can be extended to also include environmental principles. In *EC – Hormones (Canada) and (US)*, which concerned the Agreement on Sanitary and Phytosanitary Measures, the Appellate Body did not rule out that the *precautionary principle* is applicable WTO law and can be taken into account in the interpretation of the particular agreement.<sup>270</sup> However, in the specific case, the Appellate Body stated that the precautionary principle is not yet clearly substantiated as customary international law, and nor does it have a textual directive.<sup>271</sup> In case of conflict with a treaty provision, the Panel and Appellate Body have as their task to first of all interpret such provision in accordance with the customary rules of international law in the Vienna Convention, and can therefore not narrow down the interpretation with reference to a non-substantiated principle of law.<sup>272</sup>

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<sup>264</sup> See, for example, the Kyoto Protocol to the United Nations Framework Convention on Climate Change, which has 192 parties, the US being the only one not to ratify it.

<sup>265</sup> See, for example, the Cartagena Protocol on Biosafety and the Convention on International Trade in Endangered Species.

<sup>266</sup> See, for example, the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal.

<sup>267</sup> See, for example, some regional agreements: Barcelona Convention for Protection against Pollution in the Mediterranean Sea; or the Helsinki Convention on the Protection of the Marine Environment of the Baltic Sea Area.

<sup>268</sup> See, for example, United Nations Convention to Combat Desertification.

<sup>269</sup> For example, United Nations Educational, Scientific and Cultural Organisations (UNESCO) World Heritage Convention.

<sup>270</sup> The precautionary principle is defined in the WTO SPS Training Module, no 8, as ‘a notion which supports taking protective action before there is complete scientific proof of a risk; that is, action should not be delayed simply because full scientific information is lacking.’

<sup>271</sup> The precautionary principle is written into several international instruments, like Art. 15 of the Rio Declaration on Environment and Development. In practice, the application of the principle in different national systems heads towards a recognition of the principle, but international courts and tribunals have been more reluctant to apply it as customary international law. See P. Sands, *Principles of International Environmental Law* (2 edn. Cambridge: Cambridge University Press, 2003), pp. 266-279.

<sup>272</sup> WTO, *European Communities – Measures Concerning Meat and Meat Hormones (Canada) and European Communities – Measures Concerning Meat*

If the public entity applies some environmental criterion that is in violation of the GPA, it must be examined whether the criteria fulfils the exception requirement in Article XXIII.2.

As mentioned above, Article XXIII.2 of the GPA resembles Article XX of GATT 1994 in that the protection of human, animal and plant life are legitimate reasons for departing from both GATT 1994 and the GPA. However, unlike GATT 1994, the GPA does not explicitly mention exceptions 'relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.'<sup>273</sup> By not mentioning such an exception, the GPA indicates that the protection of exhaustible natural resources is not a criterion exempted from the GPA. As such, the protection of exhaustible resources can only be a criterion for awarding the contract if the other requirements, like non-discrimination, etc., in the GPA are met. The environmental exceptions in the GPA Article XXIII.2, therefore, seem narrower than the exceptions provided in GATT 1994.

The Appellate Body has made a few statements concerning GATT 1994, Article XX. In relation to Article XX of GATT 1994, the Appellate Body has stated that it is a fundamental right of a WTO Member to decide the level of protection, as long as the contribution of the level of protection is necessary to reach the aim.<sup>274</sup> It can here be argued that in cases where a WTO member has made a commitment under a multilateral environmental agreement, an awarding criterion which is in violation of the GPA will be excepted under Article XXIII.2, if it is necessary to comply with the other multilateral agreement, and the possible discrimination may then also be justified. That line also seems to be followed by the Appellate Body, which, in *US – Shrimps*, apparently emphasised the multilateral nature of international environmental agreements as a justifiable reason to invoke the exception.<sup>275</sup> What is noteworthy is that the Appellate Body furthermore applied the other multilateral

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*and Meat Hormones (US) – Report of the Appellate Body* (16 January 1996) combined cases WT/DS26 and 48/AB/R, section VI.

<sup>273</sup> Art. XX(g) of GATT 1994.

<sup>274</sup> WTO, *Brazil – Measures Affecting Imports of Retreaded Tyres- Report of the Appellate Body* (3 December 2007) WT/DS332/AB/R, para. 210.

<sup>275</sup> WTO, *United States – Import Prohibition of Certain Shrimp and Shrimp Products- Report of the Appellate Body* (12 October 1998) WT/DS58/AB/R, para. 168. See also See P. Sands, *Principles of International Environmental Law* (2 edn., Cambridge: Cambridge University Press, 2003), p. 945.

environmental agreements to define the concept ‘natural resource’ in Article XX(g),<sup>276</sup> which indicates willingness to include other international treaties as context in order to understand WTO law.

Politically, the WTO seems to emphasise environmental concerns. The Doha Ministerial Declaration provides that:

We recognize that under WTO rules no country should be prevented from taking measures for the protection of human, animal or plant life or health, or of the environment at the levels it considers appropriate, subject to the requirement that they are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, and are otherwise in accordance with the provisions of the WTO Agreements.<sup>277</sup>

The Doha Declaration gave the mandate to negotiate on the relationship between WTO rules and specific trade obligations in multilateral environmental agreements although the negotiations may not prejudice the WTO rights of those WTO Members not parties to the multilateral environmental agreements.<sup>278</sup> However, on a political level, it indicates the possibility of including environmental agreements in the understanding of WTO law between Members that are parties to the same environmental agreements.

Furthermore, in the revised version of the GPA, ‘environment’ is specifically written into the GPA. A public entity may ‘prepare, adopt, or apply technical specifications to promote the conservation of natural resources or protect the environment.’<sup>279</sup> Furthermore, environmental characteristics are mentioned as an evaluation criterion

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<sup>276</sup> WTO, *United States – Import Prohibition of Certain Shrimp and Shrimp Products- Report of the Appellate Body* (12 October 1998) WT/DS58/AB/R, para. 130.

<sup>277</sup> Para. 6 of the Doha Declaration.

<sup>278</sup> Para. 31(i) of the Doha Declaration, which suggests a reduction or elimination of tariffs and non-tariff barriers on environmental goods and services; see para. 31(iii).

<sup>279</sup> Art. X.6 in the revised GPA. See R. Anderson, ‘Reviewing the WTO Agreement on Government Procurement: Progress to Date and Ongoing Negotiations’ (2007) *Public Procurement Law Review* 255-273, at 264.

that the public entity may apply.<sup>280</sup> The political line indicates that sooner or later WTO law will put more emphasis on environmental concerns.

### **3.8 From Notice of Proposed Government Procurement to the Awarding Phase**

This part concerns the different formalities that the public entity must take into account from the initial notice of proposed government procurement to the final opening of tenders.

#### **3.8.1 Notice of Proposed Government Procurement**

In line with the transparency principle, the public entity must publish an invitation to suppliers with an interest to participate in the intended PPP. The notice with the invitation shall be published in one of the publication media which is written in Appendix II of the GPA.<sup>281</sup> For example, if a Hong Kong public entity wants to establish a PPP, it must either publish the notice in The Government of the Hong Kong Special Administrative Region Gazette or the daily press.<sup>282</sup>

The public entity must make it clear in the invitation that the GPA applies to the procurement.<sup>283</sup>

After the publication of the notice, amendments to or re-issuing of the notice must be given the same circulation as the original notice. Any significant information given to one potential supplier must be given to all other potential suppliers in adequate time to permit the potential suppliers to consider such information and to respond to it.<sup>284</sup>

The GPA distinguishes between the information requirements in the public notice depending on whether the public entity is either a central public entity (Annex 1), or a sub-central or any other public entity (Annex 2 or Annex 3).

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<sup>280</sup> Art. X.9 of the revised GPA.

<sup>281</sup> Art. IX.1 of the GPA.

<sup>282</sup> See the specific list for Hong Kong in Appendix II of the GPA.

<sup>283</sup> Art. IX.11 of the GPA.

<sup>284</sup> Art. IX.10 of the GPA.

### 3.8.1.1 Public Entities from Annex 1

A public entity from Annex 1 *shall* make the invitation to participate in the process of make tenders to establish a PPP as a *notice of proposed procurement*. The notice of proposed procurement shall contain the following information:

- (a) the nature and quantity, including any options for further procurement and, if possible, an estimate of the timing when such options may be exercised; in the case of recurring contracts the nature and quantity and, if possible, an estimate of the timing of the subsequent tender notices for the products or services to be procured;
- (b) whether the procedure is open or selective or will involve negotiation;
- (c) any date for starting delivery or completion of delivery of goods or services;
- (d) the address and final date for submitting an application to be invited to tender or for qualifying for the suppliers' lists, or for receiving tenders, as well as the language or languages in which they must be submitted;
- (e) the address of the entity awarding the contract and providing any information necessary for obtaining specifications and other documents;
- (f) any economic and technical requirements, financial guarantees and information required from suppliers;
- (g) the amount and terms of payment of any sum payable for the tender documentation;
- (h) whether the entity is inviting offers for purchase, lease, rental or hire purchase, or more than one of these methods.<sup>285</sup>

Furthermore, a *summary notice* must be provided. It shall be in one of the official WTO languages, i.e. English, French or Spanish, and it shall contain the subject matter of the contract; the time-limits set for the submission of tenders or an application to be invited to tender; and

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<sup>285</sup> Art. IX.2 and Art. IX.6.

the addresses from which documents relating to the contracts may be requested.<sup>286</sup>

### **3.8.1.2 Public Entities from Annex 2 or Annex 3**

A public entity, which is listed in Annexes 2 or 3, *may* use a *notice of planned procurement* with fewer requirements than the *notice of proposed procurement* as invitation to participate. The notice need not contain as much information as listed above, but shall, as a minimum, provide a statement that interested suppliers should express their interest in the procurement to the entity, and a contact point with the entity from which further information may be obtained. Furthermore, the abovementioned summary notice must be provided.<sup>287</sup>

The public entity shall subsequently invite all the interested potential suppliers and provide them the same information as in a notice of proposed procurement. Based on that information, the public entity shall get confirmation from the potential suppliers about their interest to participate.<sup>288</sup>

In situations with *selective tendering procedures*, a public entity from Annex 2 or Annex 3 *may* use the *notice regarding a qualification system* as an invitation to participate. Using such a notice as invitation requires, in addition, that the public entity includes information about the nature of the products or services concerned and a statement that the notice constitutes an invitation to participate.<sup>289</sup> The public entity shall, however, in a timely manner, provide the same information as in a notice of proposed procurement and the summary notice.

### **3.8.2 Time Limits and Deadlines**

The public entity will not be allowed to apply a deadline that favours a specific supplier and at the same time makes it impossible for other potential suppliers to prepare a tender. The GPA has minimum standards for deadlines. In general, Article XI of the GPA requires that any prescribed time limit shall be adequate, and the public entity

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<sup>286</sup> Art. IX.8 of the GPA

<sup>287</sup> Art. IX.3 of the GPA.

<sup>288</sup> Art. IX.4 of the GPA.

<sup>289</sup> Art. IX.9 of the GPA.

shall take into account the complexity of the intended procurement, which, in the case of PPPs, often requires a long preparation time for the potential suppliers. Furthermore, the extent of subcontracting anticipated must be taken into account by the public entity, and the normal time for transmitting tenders by mail from foreign and domestic points shall be taken into account when the public entity prescribes the time limits.

The GPA has different minimum time standards depending on the tendering procedure.

In *open tendering procedures*, there must be a minimum of 40 days between the date of publication of the notice of invitation and the date of receipt of the tenders.

In *selective tendering procedures*, there are two different types of minimum periods for deadlines depending on whether the public entity applies a permanent list of qualified suppliers:

- 1) In *selective tendering procedures without a permanent list of qualified suppliers*, there must be a minimum of;
  - 25 days between the date of the publication of the invitation and the date on which the interested potential suppliers who have submitted applications are invited to participate in the tender procedure; and
  - 40 days between the date of issuance of the invitation to tender and the date of receipt of the tenders.
- 2) In *selective tendering procedures with a permanent list of qualified suppliers*, there must be a minimum of 40 days between the date of the initial issuance of invitation to tender, whether or not the date of initial issuance of invitation to tender coincides with the date of the publication notice of invitation, and the date of receipt of the tenders.

In both the open tendering procedure and the selective tendering procedure, it is possible to make exceptions and apply shorter time periods, but only in four situations, and if certain requirements are met. The four situations are as follows:

- The public entity has published a *separate notice* a minimum 40 days and not more than 12 months in advance, and the notice contains at least as much information as mentioned in Article IX.6 and Article XI.8; see above in section 1.3.8.1; a

statement that interested suppliers should express their interest in the procurement; and a contact point where further information can be provided by the public entity. The period must be no less than 10 days;<sup>290</sup>

- In case of *contracts of recurring nature*, the public entity may use a time period of no less than 24 days for the second or subsequent publications;<sup>291</sup>
- In case of *urgent matters* where the general period renders impracticable, and the impracticability has been duly substantiated by the public entity, the period may be reduced to no less than 10 days;<sup>292</sup>
- In *selective tendering procedures with a permanent list of qualified suppliers* for procurements by entities listed in Annex 2 or Annex 3, there may be a fixed period by mutual agreement between the public entity and the selected suppliers. If no agreement concerning the time period exists, the public entity may fix the time period. The time period shall be sufficiently long so as to enable responsive tendering, and shall in no case be less than 10 days.<sup>293</sup>

Article XI.4 concerns the delivery date of the procured good, service or construction service. The delivery date must be consistent with the needs of the public entity, which must take into account such factors as: the complexity of the intended procurement; the extent of subcontracting anticipated; and the realistic time required by the suppliers for production, de-stocking and transport of goods from points of supply or for supply of services.

As PPPs often involve complex products and services, e.g. building, running, and maintaining infrastructure, it must be expected that the delivery date cannot easily be defined, and it must be expected that different delays, for example bad weather conditions, may occur.

### 3.8.3 Tender Documentation

Article XII of the GPA concerns the requirement that a public entity must meet when a potential supplier requests information concerning

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<sup>290</sup> Art. XI.3(a) of the GPA.

<sup>291</sup> Art. XI.3(b) of the GPA.

<sup>292</sup> Art. XI.3(c) of the GPA.

<sup>293</sup> Art. XI.3(d) of the GPA.



the different formalities to the tender and the award criteria. As seen above, in the notice inviting to participate in the tender procedure, the public entity must provide some information about the forthcoming procurement procedure.

The potential supplier interested in the procedure may request further information. The forwarding of such information from the public entity to the potential supplier differs depending on the type of procedure. In *open tendering procedures*, the public entity shall forward the tender documentation at the request of any potential supplier participating in the procedure. In *selective tendering procedures*, the public entity shall forward the tender documentation at the request of any potential supplier requesting to participate. Under both procedures, the public entity must reply promptly to any reasonable request for explanations to the tender documentation. Furthermore, the public entity shall reply promptly to any reasonable request for relevant information submitted by a supplier participating in the tendering procedure, on condition that such information does not give that supplier an advantage over its competitors in the procedure for awarding the contract.<sup>294</sup>

The tender documentation shall include the information which is necessary to permit the potential suppliers to submit responsive tenders. That includes the information required to be published in the notice of the intended procurement and the following:

- (a) the address of the entity to which tenders should be sent;
- (b) the address where requests for supplementary information should be sent;
- (c) the language or languages in which tenders and tendering documents must be submitted;
- (d) the closing date and time for receipt of tenders and the length of time during which any tender should be open for acceptance;
- (e) the persons authorized to be present at the opening of tenders and the date, time and place of this opening;
- (f) any economic and technical requirement, financial guarantees and information or documents required from suppliers;

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<sup>294</sup> Art. XII.3 of the GPA.

- (g) a complete description of the products or services required or of any requirements including technical specifications, conformity certification to be fulfilled, necessary plans, drawings and instructional materials;
- (h) the criteria for awarding the contract, including any factors other than price that are to be considered in the evaluation of tenders and the cost elements to be included in evaluating tender prices, such as transport, insurance and inspection costs, and in the case of products or services of other Parties, customs duties and other import charges, taxes and currency of payment;<sup>295</sup>
- (i) the terms of payment;
- (j) any other terms or conditions;
- (k) in accordance with Article XVII the terms and conditions, if any, under which tenders from countries not Parties to this Agreement, but which apply the procedures of that Article, will be entertained.<sup>296</sup>

If the public entity allows the potential suppliers to submit tenders in several languages, one of those languages shall be one of the official WTO languages, i.e. Spanish, English, or French.<sup>297</sup>

### **3.8.4 Dealing with the Tender**

Article XIII of the GPA concerns the submission, receipt and opening of the tenders and the award of the contract.

Normally, the tenders are to be submitted in writing directly or by mail. It is not written into the provision whether mail also means e-mail. However, since Article XIII.1 only prohibits tenders presented by telephone, it can be assumed that e-mail will be allowed. The public entity may also allow tenders by telex, telegram or facsimile.

The public entity may also allow the potential suppliers to correct unintended errors of form between the opening of tenders and the

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<sup>295</sup> For example, if the supplier is importing products from a country imposed with an anti-dumping duty, the government must submit that information to the suppliers if that anti-dumping duty is reflected in the tender price.

<sup>296</sup> Art. XII.2 of the GPA.

<sup>297</sup> Art. XII.1 of the GPA.

awarding of the contract if it does not give any rise to discriminatory practice.

If a tender is received after the deadline for submission of tenders, the potential supplier shall not be penalised if the delay is caused by the public entity's handling of the tender and the tender has been submitted to the office designated in the tender documentation. In exceptional circumstances, a tender may also be considered if the public entity provides for such exceptions in the procedure.

The receipt and opening of tenders must, under both the open and selective tendering procedures, be under conditions and procedures that ensure the regularity of the opening of the tenders. They shall be in accordance with the national treatment principle and the non-discrimination principle.

A supplier will be considered for the award if: 1) the supplier complies with the criteria to participate in the tendering procedure; and 2) the supplier's tender is in conformity with the essential requirements the public authority has written into the notice of invitation or the tender documentation.

If the supplier submits a tender that is abnormally lower than the other tenders, the public entity may enquire with that supplier in order to ensure that the supplier can comply with the conditions of participation and that the supplier is capable of fulfilling the terms of the contract.

As mentioned in section 1.3.7, the public entity shall make the award to the supplier who is fully capable of undertaking the contract, and whose tender is either the lowest tender or the tender which, in terms of the specific evaluation criteria set forth in the notices or tender documentation, is found to be the most advantageous. The award shall be made in accordance with the criteria and essential requirements specified in the tender documentation.

### **3.8.5 Post award period**

Once the public entity has made its decision about the award of the contract to enter the PPP, the public entity must promptly inform the other participants about the decision. It must be in writing if the participants so request.<sup>298</sup>

The public entity shall publish a notice about the award of the contract and other information in an appropriate publication media as

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<sup>298</sup> Art. XVIII.3 of the GPA.

mentioned in its Appendix II. The information must be provided not later than 72 days after the award of each contract. The notice shall contain the following:

(a) the nature and quantity of products or services in the contract award; (b) the name and address of the entity awarding the contract; (c) the date of award; (d) the name and address of winning tenderer; (e) the value of the winning award or the highest and lowest offer taken into account in the award of the contract; (f) where appropriate, means of identifying the notice issued under paragraph 1 of Article IX or justification according to Article XV for the use of such procedure; and (g) the type of procedure used.<sup>299</sup>

Furthermore, if a supplier requests an explanation of the procurement practice and procedure, or why the supplier did not qualify, or information about why its tender was rejected, the public entity must provide such information promptly.<sup>300</sup>

If the public entity finds that some of the information would impede law enforcement; or be otherwise be contrary to the public interest; or would prejudice the legitimate commercial interest of particular enterprises, public or private; or might prejudice fair competition between suppliers, the public entity may withhold such information.<sup>301</sup>

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<sup>299</sup> Art. XVIII.1 of the GPA.

<sup>300</sup> Art. XVIII.2 of the GPA.

<sup>301</sup> Art. XVIII.4 of the GPA.

## **Chapter 4**

### **Public-Private Partnerships under the EU Public Procurement Rules**

#### **1. Introduction**

As explained in 2.1.2, the term public-private partnership (PPP) is not defined at the EU level. Therefore, it should be made clear at the outset that there is currently no specific piece of binding EU legislation on public procurement covering the formulation and operation of PPPs. Instead, EU public procurement rules that are relevant to PPPs derive from the following sources:

- the Treaty on the Functioning of the EU (hereafter TFEU);
- EU public procurement directives;
- Relevant case law of the European Court of Justice (ECJ); and
- Interpretative Communications and other soft-law measures adopted by the European Commission.

While the first three sources are binding ‘hard law’, the fourth one is non-binding ‘soft law’, providing guidance for the application of the hard law, and reflecting the Commission’s understanding of the current law. Nevertheless, the Member States and the private sector have given great weight to the Communications adopted by the Commission over the years.

The application of EU public procurement rules to PPPs is not straight forward because of the complexity from both sides. On the one hand, while PPPs share a number of common characteristics, as explained in previous chapters, PPPs take many different format/models: some are based solely on contractual terms and some on institutionalised co-operative structure; some involve works or services only; and some involve the combination of both elements. On the other hand, while the EU Treaty's application is almost universal, EU public procurement directives, which lay down detailed procedural rules, maintain different treatment towards service contracts versus works contracts; public contracts versus concessions; works concessions versus service concessions; and conventional procurement from private entities versus procurement from public bodies or public-private joint ventures.

Therefore, in assessing whether a given PPP project complies with EU public procurement rules, regard must be had first of all to the *categorisation* of such a contract in order to determine *which* set of rules shall apply. Only then can one move on to look at *how* the rules shall be complied with.

Taking into consideration the diversity of PPP practices encountered in the Member States, the Commission has used two major models for categorisation in assessing applicable legal rules:<sup>302</sup>

- ***Contractual PPPs*** of a purely contractual nature, in which the partnership between the public and the private sector is based solely on contractual links; and
- ***Institutionalised PPPs*** (IPPPs) of an institutional nature, involving co-operation between the public and the private sector within a distinct entity.

Both of these categories raise specific issues regarding the application of EU procurement rules. Adopting this distinction for the discussion in this chapter, after a brief overview of the evolution of EU procurement rules in section 4.2, section 4.3 will assess the extent to which contractual PPPs are covered, firstly, by EU public procurement directives, and then by TFEU, as interpreted by the ECJ. Two sub-categories will be considered in this context: (i) contractual PPPs capable of being classified as public works or public services

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<sup>302</sup> Commission (EC), 'Green Paper on Public-Private Partnerships and Community law on public contracts and concessions' (Green Paper) COM (2004) 327 final, 30 April 2004, at p. 8.

contract, a typical example of which is the Private Finance Initiative (PFI); and (ii) concessions including works and service concessions.

Section 4.4 deals with IPPPs. While the coverage of IPPPs by EU procurement rules is largely similar to that of contractual PPPs, IPPPs do give rise to particular concerns, such as: whether they can be exempted from the application of procurement rules by virtue of the so-called ‘in-house’ exclusion; and whether the selection of a private partner for an IPPP and the award of the contract to that IPPP require two separate tendering processes.

After considering the coverage of EU procurement rules so far as various types of PPPs are concerned, Section 4.5 will provide an appraisal of the procurement procedures suitable for PPP projects developed under EU public procurement directives, with particular attention paid to the Competitive Dialogue procedure introduced in the 2004 reform. Section 4.6 concludes this chapter.

It is widely accepted that the complexity of the coverage of PPPs by EU procurement rules has jeopardised legal certainty, hindering the further promotion of PPPs. However, different views have been expressed by stakeholders regarding the necessity for PPPs to be regulated at the EU level. It is submitted that whatever form of further guidance to be provided by the Commission, be it a binding legislative instrument or soft-law measure, the core task of the Commission remains to strike the appropriate balance between legal certainty and accommodation of diverse Member States’ practices; and the balance between ensuring the observation of EU procurement rules and providing a sufficient incentive for the private sector to engage in partnerships with public bodies.

## **2. Overview of the Relevant EU Public Procurement Rules**

### **2.1 Relevant Treaty Provisions**

The former EC Treaty, like its successor, the Treaty on the Functioning of the EU, contains general rules that, *inter alia*, prohibit Member States from discriminating against other Member States – for example, by reserving contracts for domestic firms. These rules apply in principle (but with limited exceptions) to *all public procurement measures* and *all types of government contracts*, including PPPs. These can be referred to as the ‘negative’ obligations of the EU Treaty. These rules form an integral part of the EU procurement regime and

are applicable and enforceable in Member States without the need for any implementing measures.

So far as PPPs are concerned, the most important provisions are those on freedom of establishment and freedom to provide services, which are found in Articles 49 and 56 TFEU ( ex. Articles 43 and 49 EC respectively).<sup>303</sup> The ECJ has made it clear that whenever a public authority ‘entrusts the supply of economic activities to a third party’, the action would need to be examined in the light of these provisions.<sup>304</sup> Furthermore, as the Commission noted, certain general principles of EU law emerging from the ECJ's case law would also need to be observed, in particular the principles of transparency, equality of treatment, proportionality, and mutual recognition.<sup>305</sup> Some of these principles, namely transparency and equal treatment, have, arguably, gone beyond merely ‘negative’ obligations and amounted to ‘positive’ obligations covering all public procurement, including those outside the scope of the Public Procurement directives.<sup>306</sup>

## 2.2 EU Public Procurement Directives

These Treaty principles alone were considered insufficient to open procurement markets. In particular, it was considered that it was necessary for contracts to be awarded by transparent procedures so that authorities awarding public contracts could not disguise any discriminatory behaviour under a cloak of discretion. Further, special provisions were considered desirable to ensure that the rules could be effectively enforced by aggrieved bidders.

To ensure this, the EU has adopted directives which regulate award procedures for major contracts - these require, for example, that states should advertise their contracts across Europe and should award

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<sup>303</sup> Provisions on the free movement of goods are of relatively little relevance to PPPs.

<sup>304</sup> Case C-458/03 *Parking Brixen GmbH v Gemeinde Brixen and Stadtwerke Brixen AG* [2005] ECR I-08585, at para. 61.

<sup>305</sup> See Commission (EC), ‘Interpretive Communication of the Commission on Concessions under Community law’ (Communication) OJ C 121/2, 29 April 2000.

<sup>306</sup> See further section 4.3.2 below where discussion is based on Cases C-147/06 and C-148/06 *SECAP v Comune di Torino*, ECJ judgment of 15 May 2008; and Case C-324/98 *Telaustria Verlags GmbH and Telefonadress GmbH v Telekom Austria and Herold Business Data AG* [2000] ECR I-10745.



them using only commercial criteria. It has also adopted a special directive on remedies. A directive is a form of legislation which requires each Member State to ensure that it has appropriate laws in its own legal system to implement the rules of the directive. Most Member States have had to adopt new legislation to give effect to the obligations contained in these directives.

Procurement procedures are regulated by two main directives:

- The Public Sector Directive  
Directive 2004/18/EC – hereafter the Public Sector Directive. This regulates most of the major contracts awarded by public bodies (government departments, local authorities etc).
- The Utilities Directive  
Directive 2004/17/EC – hereafter the Utilities Directive. This regulates bodies engaged in certain activities in the sectors of water, transport, energy and postal services ('utility activities'). Bodies whose procurement is, in general, covered by the Public Sector Directive are covered by the Utilities Directives where they engage in the utility activities. The Utilities Directive is not confined to the public sector but also applies to a number of other bodies engaged in 'utility' activities, including many in the private sector that can be classified as 'public undertakings'.

Remedies for enforcing the above rules are dealt with in two other directives:

- The Public Sector Remedies Directive  
Directive 89/665/EEC – hereafter the Public Sector Remedies Directive – deals with remedies for enforcing the EU procurement rules applying to contracts governed by the Public Sector Directive.
- The Utilities Remedies Directive  
Directive 92/13/EEC Directive 89/665/EEC – hereafter the Utilities Remedies Directive – deals with remedies for enforcing the EU procurement rules applying to contracts governed by the Utilities Directive.

These directives on remedies have recently been significantly amended by Directive 2007/66/EC - hereafter 2007 Amending Remedies Directive.

The current procurement directives were adopted only in 2004, and were required to be implemented in Member States by 1 January 2006. The history of the directives regulating contract award

procedures goes back to 1971, when a directive was adopted to regulate public works contracts: Directive 71/305/EEC. In 1977, a directive was adopted applying similar rules to public supply contracts: Directive 77/62. The late 1980s and early 1990s saw a wave of reforms of the public procurement rules. These formed part of the European Commission's drive to complete the single market by 1992. The various provisions on works and supplies were brought together in 1993 in two consolidated texts (which also introduced some small amendments): Directive 93/36/EEC on supply contracts; and Directive 93/37/EEC on public works contracts. The regulatory system was also extended to works and supply contracts awarded in previously excluded 'utilities' sectors in 1990, by Directive 90/531/EEC; to public services contracts in 1992, by Directive 92/50/EEC; and to services contracts awarded by utilities in 1993, by Directive 93/38/EEC. The two directives on remedies referred to above (in 1989 for the public sector and 1992 for the utilities sector) were also adopted during this period.

Immediately prior to the 2004 directives the main directives were thus:

1. Directive 93/36 on public supply contracts;
2. Directive 93/37 on public works contracts;
3. Directive 92/50 on public services contracts;
4. Directive 93/38 on utilities contracts (works, supplies and services);
5. Directive 89/665 on remedies for contracts governed by Directives 93/36, 93/37 and 92/50; and
6. Directive 92/13 on remedies for contracts governed by Directive 93/38 (utilities).

In the 1990s, an extensive reform programme occurred, leading to substantial revisions and consolidation. After a lengthy legislative process (of nearly four years), involving many amendments to the original proposals, and including a conciliation procedure, two new directives were adopted. These are the current Public Sector Directive and Utilities Directive referred to above. The basic approach and provisions of these are the same as the old directives and, thus, much of the old case law remains relevant. However, many important changes were introduced. Particularly relevant to PPPs, a new competitive dialogue procedure was introduced in the Utilities Directive, with a view to facilitating efficient and transparent procurement of PPPs (see further section 4.5 below). Despite these simplifying provisions, the rules remain complex and detailed. Since

the adoption of the 2004 directives, the EU has completed or commenced certain other initiatives for strengthening the procurement regime; in particular, the 2007 Amending Remedies Directive and a new directive on defence procurement have been created.

### **2.3 Commission Initiatives to Provide Legal Guidance**

Over the years, the European Commission has produced a number of documents, mainly in the form of Communications, to provide guidance on the application of EU procurement rules to PPPs. These include:

- Commission (EC), ‘Interpretive Communication of the Commission on Concessions under Community law’ (Communication) OJ C 121/2, 29 April 2000;
- Commission (EC), ‘Green Paper on Public-Private Partnerships and Community law on public contracts and concessions’(Green Paper) COM (2004) 327 of 30 April 2004;
- Commission (EC), ‘Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on Public-Private Partnerships and Community Law on Public Procurement and Concessions’ (Communication) COM (2005) 569 final, 15 November 2005;
- Commission (EC), ‘Interpretative Communication on the application of Community law on public procurement and concessions to Institutionalised Public-Private Partnerships (IPPPs)’ (Communication) C (2007) 6661, 5 February 2008;
- Commission (EC), ‘Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Mobilising private and public investment for recovery and long term structural change: developing Public Private Partnerships’ (Communication) COM (2009) 615 final, 19 November 2009.

These documents are non-binding soft-law. They have, nevertheless, to a certain extent, clarified how EU public procurement rules shall

apply to different type of PPPs. Since these initiatives summarise the Commission's understanding of the current legislation and case law, the Member States and the private sector have given great weight to them in order to minimise legal risks. The discussion in the following sections will also use such guidance whenever available as a starting point.

It is noteworthy that the Commission has adopted different approaches towards concessions in contrast with IPPPs. On the one hand, regarding concessions, the Commission has announced and reinstated its intention to produce a proposal for a legislative instrument on concessions based on ongoing impact assessments,<sup>307</sup> despite the fact that there has been significant stakeholder opposition to a regulatory regime covering all contractual PPPs.<sup>308</sup> On the other hand, regarding IPPPs, the Commission is satisfied at the moment with an Interpretative Communication as 'the best way to encourage effective competition and to provide legal certainty', since 'a non-binding initiative in this area would provide the required guidance without stifling innovation'.<sup>309</sup>

The proposed legislation will only cover concessions, rather than all contractual PPPs. It is quite likely that the proposal will include an award procedure similar to that of the negotiated procedure with regards to competition under the directives (see further section 4.5 below). It is unclear whether making a distinction between the rules applied to concessions and other contractual PPPs, such as PFI projects, is the right way forward. They involve exactly the same problems: very long-term contracts; long award procedures; bids submitted mainly by consortia; high procedural costs; involvement of private finance; the need for discussions to design and adjust the project; etc. Nonetheless, since the proposal will be based on ongoing

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<sup>307</sup> See Commission (EC), 'Green Paper on Public-Private Partnerships and Community law on public contracts and concessions' (Green Paper) COM (2004) 327, 30 April 2004; and Commission (EC), 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Mobilising private and public investment for recovery and long term structural change: developing Public Private Partnerships' (Communication) COM (2009) 615 final, 19 November 2009.

<sup>308</sup> See Commission (EC), 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on Public-Private Partnerships and Community Law on Public Procurement and Concessions' (Communication) COM (2005) 569 final, 15 November 2005, at 2.3.1.

<sup>309</sup> *ibid.*, section 4.1.

impact assessments, the Commission will need to justify its approach by relying on concrete data subject to the scrutiny of stakeholders.

### **3. Coverage of Contractual PPPs by EU Public Procurement Rules**

This section will examine the extent to which EU public procurement rules are applicable to two types of contractual PPPs, namely: concessions; and others that may be classified as public contracts under the directives, a typical example of which is the Private Finance Initiative (PFI) project. The choice and operation of the award procedure for contractual PPPs covered by Public Procurement Directives (mainly PFI projects) will be analysed in section 4.5.

#### **3.1 Concessions under EU Public Procurement Directives<sup>310</sup>**

Arrangements classified as works concessions or services concessions are covered by different rules from other procurement arrangements under the directives. In essence, services concessions are wholly excluded whilst works concessions are subject only to limited obligations. Since the treatment of concessions is identical under the Public Sector Directive and the Utilities Directive, the following discussion will focus on the Public Sector Directive only.

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<sup>310</sup> See S. Arrowsmith, 'The European Procurement Rules and Public Private Partnerships: EU Policies in Conflict?' (2000) 37 *Common Market Law Review* 709; S. Arrowsmith, *The Law of Public and Utilities Procurement* (2nd edn., London: Sweet & Maxwell, 2005), pp.320-331 (services concessions) and pp.818-823; S. Arrowsmith and P Badcoe (eds.), *Public Private Partnerships and PFI* (London: Sweet & Maxwell, 1999), 8.039-8.056; C. Davis, 'EC Proposals on Public Service Contracts for Passenger Transport' (2002) 11 *Public Procurement Law Review* 114; F. Hausmann, 'Public Private Partnerships and the Award of Concessions' (1999) 8 *Public Procurement Law Review* 269; U. Neergaard, 'Public service concessions and related concepts - the increased pressure from Community law on Member States' use of concessions' (2007) 16 *Public Procurement Law Review* 387; U. Neergaard, 'The Concept of Concession in EU Public Procurement Law Versus EU Competition Law and National Law', in R. Nielsen and S. Treumer (eds.), *The New EU Public Procurement Directives* (Copenhagen: Djøf 2005); J. Skilbeck, 'The Private Finance Initiative and Public Procurement' (1996) 5 *Public Procurement Law Review* 148; C. Tvarnø, 'Public Private Partnership in the European Union', in R. Nielsen and S. Treumer (eds.), *The New EU Public Procurement Directives* (Copenhagen: Djøf 2005); R. Williams, 'The European Commission's Interpretative Communication on Concessions Under Community Law' (2000) 9 *Public Procurement Law Review* NA105.

### 3.1.1 Definition of Concessions in the Directives

A public works concession is defined in the Public Sector Directive, Article 1(3), as a contract...

of the same type as a public works contract except for the fact that the consideration for the works to be carried out consists either solely in the right to exploit the work or in this right together with payment.<sup>311</sup>

An example of a works concession would be where a contractor who has built a road or bridge is remunerated by being permitted to collect tolls from users for a set period.

A service concession is defined in the Public Sector Directive, Article 1(4), as a contract...

a contract of the same type as a public service contract except for the fact that the consideration for the provision of services consists either solely in the right to exploit the service or in this right together with payment.<sup>312</sup>

Examples of services concession would be where a consortium is required to build and operate an urban tramway system, and is paid by being permitted to collect fares from users; or where a firm contracts to build and operate a leisure centre for a local authority and is remunerated by charging users of the facilities.

Exploitation entails that the provider assumes the economic risk arising from the provision and management of the services.<sup>313</sup> Under a typical service concession, the risk arises out of the fact that the service provider bears the cost of providing the service, and obtains income to cover those costs and make a profit only if it is successful in generating revenue by exploiting the services by selling them to the public. In such a case, a significant element of the economic risk is the demand risk – the risk concerning the extent to which third parties will

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<sup>311</sup> A parallel definition is contained in the Utilities Directive Article 1(3)(a).

<sup>312</sup> A parallel definition is contained in the Utilities Directive Article 1(3)(b).

<sup>313</sup> It was stated by Advocate General Pergola, in Case C-360/96 *Gemeente Arnhem v BFI Holding BV BFI/Arnhem* [1998] E.C.R. I-6821 (para. 26 of the Opinion), that exploitation entails that the provider ‘assumes the economic risk arising from the provision and management of the services’.

choose to use the service. An arrangement is not a concession if the terms of the contract remove or substantially limit any element of risk for the provider. For example, if an agreement were to provide a guaranteed reasonable level of income from the procuring entity in the case of the user fees not being sufficient, this might not be a service concession.<sup>314</sup> The Commission's Interpretative Communication on Concessions also suggests that if 'recovery of expenditure' is guaranteed, there is an insufficient element of risk for a concession.<sup>315</sup>

For a project to be considered as a concession it is also necessary that the remuneration for providing the services should not come from the contracting authority itself. The definition of a concession was considered in the UK by Beatson J in the High Court in the *Legal Services Commission* case,<sup>316</sup> which concerned framework arrangements for appointing solicitors to deal with legal aid cases. The judge considered that the arrangements in that case did not meet the definition, since it is only if consideration does not pass from the contracting authority itself that the arrangement is a concession (para. 65), and it did so in the case (in general, the Legal Services Commission, and not the clients, made payment for the work). Beatson J considered it an insufficient basis for a concession under this principle that the contractor bore the economic risk that the public would not choose the contractor's services (para. 65). In other words, whilst economic risk is necessary for a concession, it is not sufficient – it is additionally necessary that the consideration should come from persons other than the contracting authority itself.

As can be seen from the definition in the directives as stated above, an agreement can be a concession if only part of the income comes from exploitation, but it is not clear how great that part must be. In *Legal Services Commission* in the UK, the judge held it to be irrelevant that some payments came from clients, since these were not a 'significant' proportion (para. 68), but did not give guidance on what proportion would need to come from the public to make the arrangement a concession. Beatson J in *Legal Services Commission*

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<sup>314</sup> Case C-382/05 *Commission v Italy* [2007] ECR I-6657 (Italy waste processing contract); and Case C-437/07 *Commission v Italy*, ECJ judgment of 13 November 2008.

<sup>315</sup> Commission (EC), 'Interpretive Communication of the Commission on Concessions under Community law' OJ C 121/2, 29 April 2000, fn. 9.

<sup>316</sup> *R (on the application of the Law Society) v Legal Services Commission* [2007] EWCA Civ 1264.

also held that – as seems very clear – it is not sufficient for a concession simply that the beneficiaries are the public (para.69).

### **3.1.2 Current rules in the directives on concessions**

Services concessions are expressly excluded from the Public Sector Directive (Article 17) and the Utilities Directive (Article 18). There was no explicit exclusion until 2004.

In Articles 56-61 of the Public Sector Directive, there are special rules for public works concession contracts.

The award of a works concession by a contracting authority is not subject to the same rules as the award of other works contracts, but is subject only to an obligation to advertise the contract in the Official Journal, and to give at least 52 days (as a general rule) for firms to respond. As with open procedures, extensions may be required for on-site visits, etc., and may be reduced by 7 days when the authority transmits the notice in the electronic form laid down in the directive. There are no explicit rules concerning, for example, the kind of procedure to be used – indeed there is not even any requirement to hold a competition - or the award criteria to be applied.

Note also that, in addition, the Directive place obligations on a party holding a works concession when awarding its own works contracts (sub-contracts) for the purpose of the concession, even though the concessionaire is itself not a contracting authority (Articles 62-65).

A key reason why concessions have been treated differently under the directives is that, in the legal system of some Member States, they are not regarded as ordinary procurement, but as a different type of legal relationship altogether, and have not been regulated by public procurement law. However, this kind of contract is of particular interest to cross border trade as the contracts involved are very large, extending over a long period of time (25-30 years, or more in some cases), and potentially very profitable. It was argued that the lack of a coherent legal instrument co-ordinating the award of concessions across the EU provides contracting authorities with significant discretion which hinder the opening up of pan-EU competition;



discourage bidders; and deprive the internal market of healthy competition for PPPs.<sup>317</sup>

### 3.2 The EU Treaty and general principles of EU law

As explained above, any act of a State laying down the terms governing economic activities, is subject to the EU Treaty's fundamental free movement rules, including the free movement of goods, services and persons (establishment).<sup>318</sup>

While the EU Treaty does not restrict Member States' freedom to grant concessions, the methods used to do so must be compatible with Community law. There is nothing in the Treaty or in the Court's case law which implies that concessions would be treated differently under the EU Treaty.

Indeed, not only concessions, but also other contractual PPPs or IPPPs that are outside of the scope of the Public Procurement Directives, must comply with Treaty rules and principles, provided no justification for derogation can be found in the grounds contained in the Treaty itself (or in 'objective justifications' if the measure is indistinctly applicable; see 4.3.2.3 below). Therefore, the discussion in this section is of wider relevance to all PPPs.

The legal situation regarding public service concessions and PPPs outside of the scope of the directives has been summarised clearly by the ECJ in the *ANAV* case, which involved a public service concession awarded directly without completion to a company wholly owned by the procuring municipality:

18 Notwithstanding the fact that public service concession contracts are excluded from the scope of [Public Sector Directive], the public authorities concluding them are, none the less, bound to comply with the *fundamental rules of the EC Treaty*, in general, and *the principle of non-discrimination on the ground of nationality*, in particular (...).

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<sup>317</sup> A. Calleja, The Legal and Policy Considerations in the Award of Public-Private Partnerships (2010)(2) *European Public Private Partnership Law Review*, at p. 100.

<sup>318</sup> Commission (EC), Interpretive Communication of the Commission on Concessions under Community law (Communication) OJ C 121/2, 29 April 2000, at Section 3.

19 The provisions of the Treaty which are specifically applicable to public service concessions include, in particular, Article 43 EC and Article 49 EC (...).

20 Besides the principle of non-discrimination on grounds of nationality, *the principle of equal treatment of tenderers* is also to be applied to public service concessions even in the absence of discrimination on grounds of nationality (...).

21 The principles of equal treatment and non-discrimination on grounds of nationality imply, in particular, *a duty of transparency* which enables the concession-granting public authority to ensure that those principles are complied with. That obligation of transparency which is imposed on the public authority consists in ensuring, for the benefit of any potential tenderer, *a degree of advertising sufficient to enable the service concession to be opened up to competition and the impartiality of procurement procedures to be reviewed* (...).<sup>319</sup>

The Commission also recognises that PPPs and concessions are subject not only to Treaty provisions on free movement but also to the principles emerging from the Court's case law, notably the principles of non-discrimination, equality of treatment, transparency, mutual recognition, and proportionality.<sup>320</sup>

So far as concessions are concerned, we will firstly look at the application of basic 'negative' free movement obligations, in particular Articles 49 on establishment and 56 TFEU on services (ex. Articles 43 and 49 EC respectively); then the application of 'positive' obligations derived from the general principles of transparency and equal treatment to concessions will be examined.

### **3.2.1 Article 56 TFEU on freedom to provide services**

Article 56 TFEU is concerned with opening the market for nationals of one Member State who wish to provide services (including

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<sup>319</sup> Case C-410/04 *ANAV v Comune di Bari* [2006] E.C.R. I-3303, at para.20, emphasis added and footnote omitted.

<sup>320</sup> Commission (EC), Interpretive Communication of the Commission on Concessions under Community law (Communication) OJ C 121/2, 29 April 2000, at Section 3.

construction) in another, whilst based in their home State. It covers both those who wish to base themselves temporarily abroad (for example, a consultant travelling to work on a project in another State) or send their employees abroad, as well as those who propose to carry out services in other States whilst remaining in their home State. The provision prohibits a Member State from preventing Community enterprises from other Member States from providing services within its territory. This will certainly cover any restriction adopted by one Member State preventing concessionaires of other Member States from participation in its public concession contracts.

Article 56 TFEU may be infringed by three types of measures, which are set out below.

### **3.2.1.1 Measures that discriminate directly on grounds of nationality of the service provider**

One example would be a rule that prohibits all foreign bidders from participating in a concession project; gives preferential treatment to domestic bidders in concession projects; or applies qualification conditions to firms from other Member States that are not also applied to domestic firms. Italian legislation requiring contractors for certain public works contracts to reserve a proportion of the works for subcontractors who had their registered office in the region of the works was held, by the ECJ, to be contrary to Article 49 EC (now Article 56 TFEU), since this discriminated directly against potential sub-contractors established outside Italy (it being irrelevant that some firms established in Italy were also affected).<sup>321</sup>

### **3.2.1.2 Measures which apply equally to domestic firms and those from other Member States but which have the effect of favouring domestic firms**

Indirectly discriminatory measures which apply equally to domestic firms and those from other Member States but have the effect of favouring domestic firms are also caught. For example, domestic legislation giving preferences to consortia and joint ventures involving the participation of firms whose main activity was in the region of the works was held, by the ECJ, as being contrary to Article 49 EC (now Article 56 TFEU), since it favoured enterprises established in Italy,

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<sup>321</sup> Case C-360/89 *Commission v. Italy* (1992] E.C.R. I-3401.

which were more likely than other enterprises to have their main activities in the region concerned.<sup>322</sup>

Article 56 TFEU also covers any limitations on bringing the provider's own labour force into the host state in order to work on the contract. In *Storebaelt*, a clause requiring use of Danish labour as far as possible, in a contract for the construction of a bridge, was also held to be contrary to this provision.<sup>323</sup>

### **3.2.1.3 Measures that have an equal impact on domestic and non-domestic firms**

In its general case law on Article 56 TFEU, the ECJ has taken the approach that all measures that have an impact on trade in services are *prima facie* covered, even when these do not discriminate directly or indirectly against service providers from other Member States, and can only be allowed if they are justified by Treaty derogations on public interest requirements.<sup>324</sup>

This approach seemed also to be applied by the ECJ in relation to procurement in the case of *Contse*.<sup>325</sup> The ECJ seemed to assume, in that case, that any kind of restrictions on access to public contracts, such as conditions on the qualifications of bidders, must be justified (which will include showing that the measure was necessary and proportionate). For example, an authority might decide to set a condition that a firm should have 20 years experience to bid for a concession contract to provide tram services. If justification is necessary, this would be very difficult to justify on any grounds of quality, etc., and probably would thus breach the Treaty, even though it is a condition which affects domestic and foreign firms in the same way. However, it can be pointed out that all the measures considered in *Contse* had a greater impact on non-domestic firms than on domestic firms, i.e. they were indirectly discriminatory.

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<sup>322</sup> *ibid.*

<sup>323</sup> Case C-243/89 *Commission v Kingdom of Denmark ("Storebaelt")* [1993] ECR I-3353.

<sup>324</sup> Case C-384/93, *Alpine Investments B.V. v Minister van Financien* [1995] ECR I-1141.

<sup>325</sup> Case C-234/03 *Contse v Insulad* [2005] I-9315.

### **3.2.2 Article 49 TFEU (ex 43 EC) on freedom of establishment**

Article 49 TFEU is concerned with the freedom of persons from one State to set up business (establish) on a permanent basis in another State: States must allow persons from other Member States both to establish in their territory and to operate under the same conditions as nationals.

Measures that restrict access to public contracts, including concessions, for such persons may infringe this provision. In *Re Data Processing*, Italian legislation limiting participation in certain data processing contracts to firms wholly or mainly in Italian public ownership was held to infringe ex Articles 43 and 49 EC. Since, in practice, all data processing firms in Italian public ownership were Italian, the provision thus discriminated against non-nationals, both those established in Italy (ex Article 43 EC), and those in other Member States (ex Article 49 EC).<sup>326</sup>

### **3.2.3 Derogations and limitations on the Treaty free movement rules**

Restrictions on the freedom of establishment and the freedom to provide services are allowed only if they are justified by one of the reasons stated in Articles 51, 52 and 62 TFEU (ex Article 45, 46 and 55 EC). Article 52 TFEU (cross-referred in Article 62) provides for express derogations on grounds of 'public policy, public security or public health'. Article 51 TFEU allows restrictions on the freedom of establishment and the freedom to provide services in the case of activities connected, even occasionally, with the exercise of official authority.

Article 51 TFEU is of particular interest to concessions since any activity delegated by the public authorities normally has a connotation of public interest, and one may wonder whether such activity necessarily involves exercising official authority. The ECJ has stressed that since it derogates from the fundamental rule of freedom of establishment, Article 51 TFEU 'must be interpreted in a manner which limits its scope to what is strictly necessary in order to safeguard the interests which it allows the Member States to

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<sup>326</sup> Case C-3/88 *Commission v Italy* ('*Re Data Processing*') [1989] E.C.R. 4035.

protect'.<sup>327</sup> The Commission is also very cautious about this exception, and stated that this exception 'must apply only to cases in which the concessionaire directly and specifically exercises official authority' and, therefore, 'does not automatically apply to activities carried out by virtue of an obligation or an exclusivity established by law or qualified by the national authorities as being in the public interest'.<sup>328</sup>

The ECJ dismissed the application of the Article 51 TFEU (ex Article 45 EC) in cases where the activities transferred remained subject to supervision by the official authorities, which had at their disposal appropriate means for ensuring the protection of the interests entrusted to them;<sup>329</sup> and where the activities transferred were of a technical nature and therefore not connected with the exercise of official authority.<sup>330</sup>

Even when no explicit Treaty derogation applies, the ECJ has recognised that an '*indistinctly applicable*' measure, which does not draw a direct distinction between domestic and imported products, is allowed if it can be justified on one of public interest grounds—referred to as 'mandatory requirements' under goods, and either 'imperative requirements' or 'objective justifications' under services - recognised by the Court. These grounds, contained in a non-exhaustive list to which the ECJ may add if it considers it to be appropriate, include protection of consumers, environmental protection, the effectiveness of fiscal supervision, and improvement of working conditions.<sup>331</sup>

The principle of proportionality, a general principle of EU law, requires that any derogation restricting the exercise of the fundamental freedoms, Treaty based or 'imperative requirements', should be both necessary and appropriate in the light of the objectives pursued. This implies, in particular, that, in the choice of the measures for achieving the objective pursued, the Member State must give preference to those

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<sup>327</sup> Case 147/86 *Commission v. Greece* [1988] ECR 1637; Case 2/74 *Reyners* [1974] ECR 631.

<sup>328</sup> Commission (EC), 'Interpretive Communication of the Commission on Concessions under Community law' (Communication) OJ C 121/2, 29 April 2000, at Section 3.1.5.

<sup>329</sup> Case 147/86 *Commission v Hellenic Republic* [1988] ECR 1637

<sup>330</sup> C-272/91 *Commission v Italian Republic* (Concession for the lottery computerisation system, *Lottomatica*) ECR [1994] I-01409

<sup>331</sup> Case 21/88 *Du Pont de Nemours Italiana SpA v Unita Sanitaria Locale No.2 Di Carrara* [1990] E.C.R. I-889

which least restrict the exercise of these freedoms. In *Re Data Processing* mentioned above,<sup>332</sup> Italy claimed in their defence that the restriction on the participants being publicly owned can be justified under ex Article 46 and 55 EC because some of the systems related to the functions of public security (such as systems concerned with the fight against organised crime) and health (systems concerned with health-care service). This argument was rejected as the measure in question is disproportionate. The ECJ considered that the objective of safeguarding public security and health could be achieved by less restrictive measures, in particular by imposing a duty of secrecy on the provider's staff with possible criminal sanctions. The Court considered that the effectiveness of such measures would not be affected by whether or not the company was under Italian public ownership.

### **3.2.4 Application of the principle of equal treatment**

In two Communications on procurement, the Commission put forward the view that there is a general equal treatment principle under the EC Treaty that is similar to that under the Directive and applies to all discriminatory treatment, not just discrimination on grounds of nationality.<sup>333</sup>

The jurisprudence cited by the Commission for its arguments<sup>334</sup> based on the principle of equality was, in fact, concerned with a principle of equal treatment derived from the directives, not from the Treaty itself. In particular, whilst the Commission in its arguments in the *Walloon Buses* cases, sought to locate the principle in issue in the Treaty rather than the directives, the Court of Justice in that case deliberately based its findings of the effect of the principle on the directives alone. This flaw in the Commission's reasoning has led to criticism by many academics who have taken the view that no such principle exists under the Treaty, which imposes only an obligation

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<sup>332</sup> Case C-3/88 *Commission v Italy* ('*Re Data Processing*') [1989] E.C.R. 4035.

<sup>333</sup> Commission (EC), Interpretive Communication of the Commission on Concessions under Community law (Communication) OJ C 121/2, 29 April 2000; and Commission (EC), 'Interpretive Communication on the Community law applicable to contract awards not or not fully subject to the provision of the Public Procurement Directives' (Communication) OJ C179/2, 23 June 2006.

<sup>334</sup> Case C-243/8, *Storebaelt* [1993] ECR I-03353, para. 37; Case C-87/94 *Commission v. Belgium* (Walloon Buses) [1996] ECR I-02043.

not to treat firms unequally on grounds of nationality.<sup>335</sup> However, recent ECJ jurisprudence accepts the Commission's view that such a general principle exists in the public procurement context.<sup>336</sup>

### 3.2.5 Application of positive transparency obligation/duty

For a long time it was assumed that the impact of the EU Treaty on public procurement was merely the laying down of '**negative**' obligations, through basic free movement rules, prohibiting Member States from adopting measures that restrict access to contracts, such as discriminatory conditions for participating or discriminatory award criteria. However, *Telaustria* case<sup>337</sup> suggested that certain '**positive**' obligations apply under the Treaty, including an obligation to advertise contracts. While the ECJ held the services concession contract concerned in the case to be outside the coverage of directives, the Court further stated that the Treaty non-discrimination principle implies an obligation of transparency, entailing 'a degree of advertising sufficient to enable the services market to be opened up to competition and the impartiality of the procurement process to be reviewed' (para. 61-62 of the judgment).

The *Telaustria* case<sup>338</sup> arose out of an award procedure by an Austrian procuring entity, Telekom Austria (a publicly owned telecommunications company), for a service concession contract for the compilation and production of telephone directories under which the service provider was not to be remunerated directly, but to be permitted to exploit the directories for commercial purposes. The Austrian Federal Procurement Office was required to decide whether the award procedure was regulated under the directives, either by the Services Directive 92/50, a predecessor to the current Public Sector

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<sup>335</sup> S. Arrowsmith, *The Law of Public and Utilities Procurement* (2<sup>nd</sup> ed., London: Sweet & Maxwell, 2005), at 4.16; P. Braun, 'A Matter of Principle(s): the Treatment of Contracts Falling Outside the Scope of the European Public Procurement Directives' (2000) 9 *Public Procurement Law Review* 39.

<sup>336</sup> Case C-410/04 *ANAV v Comune di Bari* [2006] ECR I-3303, at para.20, which provides that '[B]esides the principle of non-discrimination on grounds of nationality, the principle of equal treatment of tenderers is also to be applied to public service concessions even in the absence of discrimination on grounds of nationality'.

<sup>337</sup> Case C-324/98 *Telaustria Verlags GmbH and Telefonadress GmbH v Telekom Austria and Herold Business Data AG* [2000] ECR I-10745.

<sup>338</sup> Case C-324/98 *Telaustria Verlags GmbH and Telefonadress GmbH v Telekom Austria and Herold Business Data AG* [2000] ECR I-10745.



Directive, or the Utilities Directive 93/38, a predecessor to the current Utilities Directive 2004/18.

In answering the questions referred by the Austrian review body, the ECJ concluded that the Utilities Directive did not apply to services concessions.<sup>339</sup> The Court also stated, however, in order to assist the national review authority, that services concessions must be awarded in accordance with the principles of the EC Treaty, including the principle of non-discrimination on grounds of nationality, which implies ‘in particular’ an obligation of transparency. According to the Court, this transparency obligation...

consists in ensuring, for the benefit of any potential tenderer, a degree of advertising sufficient to enable the services market to be opened up to competition and the impartiality of the procurement process to be reviewed. (para. 62).

This case is a landmark because it overturned the presumption that as mentioned above, the EU Treaty only lays down ‘negative’ obligations, through basic free movement rules, prohibiting Member States from adopting measures that restrict access to public contracts, such as discriminatory conditions for participating or discriminatory award criteria.<sup>340</sup> The existence of this duty of transparency has subsequently been confirmed by the ECJ in the *ANAV* case<sup>341</sup> and the *Parking Brixen* case<sup>342</sup>.

However, it is not clear what is necessary to satisfy this requirement of transparency in the context of concessions (which were the subject of *Telaustria*), or in the context of other contracts that are outside the directive but covered by the Treaty, in particular non-priority services contracts (see section 4.3.4 below).

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<sup>339</sup>At that point, service concessions were not explicitly excluded by the directives. The exclusion introduced in the current directives codified the Court’s finding in this case.

<sup>340</sup> It is noteworthy that the ECJ noted in an earlier case (Case C-275/98 *Unitron Scandinavia* [1999] ECR I-08291) that ‘the principle of non-discrimination on grounds of nationality cannot be interpreted restrictively. It implies, in particular, an obligation of transparency in order to enable the contracting authority to satisfy itself that it has been complied with’ (para 31). However, the Court did not elaborate any further.

<sup>341</sup> See Case C-410/04 *ANAV v Comune di Bari* [2006] ECR I-3303, at para. 21.

<sup>342</sup> Case C-458/03 *Parking Brixen* [2005] ECR I-0000, at para.49.

First, it is not clear whether contracts must be advertised in Europe-wide media, such as the Official Journal.

Secondly, it is not clear what information is required in the advertising. It seems unlikely that each individual contract needs to be advertised since, for some covered entities, this is not even required by the directives - a general notice of contracts or a notice of a qualification system will suffice.

Third, it is not clear what obligations follow after the contract has been advertised – whether a formal competition must be held, and in what form.

Some guidance has been provided by the Commission. It considers that this obligation to ensure transparency, implied by the principle of non-discrimination on grounds of nationality, can be met ‘by any appropriate means’ and, in particular, under the following circumstances:

- Advertising depending on, and to allow account to be taken of, the particularities of the relevant sector; and
- The advertisement can be done through, for example, publishing a tender notice or pre-information notice in the daily press or specialist journals or by posting appropriate notices; and
- The advertisement shall contain the information necessary to enable potential concessionaires to decide whether they are interested in participating (e.g. selection and award criteria, etc.), including the subject of the concession and the nature and scope of the services expected from the concessionaire.<sup>343</sup>

### **3.3 Other Contractual PPPs under EU Public Procurement Directives**

In contractual PPPs, other than concessions, the private partner is called on to carry out and administer an infrastructure for the public authority (for example, a school, a hospital, a penitential centre, a transport infrastructure). The most typical example of this model is the ‘Private Finance Initiative’ (PFI) set-up. In this model, the remuneration for the private partner does not take the form of charges paid by the users of the works or of the service, but of regular

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<sup>343</sup> Commission (EC), Interpretive Communication of the Commission on Concessions under Community law (Communication) OJ C 121/2, 29 April 2000, at Section 3.1.2.

payments by the public partner. These payments may be fixed, but may also be calculated in a variable manner, on the basis, for example, of the availability of the works or the related services, or even the level of use of the works.

The PFI was formally launched in November 1992 in UK (although private finance had been used to some extent before then). It began in central government but has now been increasingly used in local government and in the National Health Service (the health service run and funded by the public sector).<sup>344</sup>

In assessing the coverage of PFI contracts by the directives, regard must be had firstly to the definition of categorisation of public contracts. The Directives apply to ‘public contracts’ defined as:

contracts for pecuniary interest concluded in writing between one or more economic operators and one or more contracting authorities and having as their object the execution of works, the supply of products or the provision of services

within the meaning of the Directives.<sup>345</sup> The term, economic operator, a simplified term for contractor, supplier and service provider, covers ‘any natural or legal person or public entity or group of such persons

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<sup>344</sup> See further S. Arrowsmith, *The Law of Public and Utilities Procurement* (2<sup>nd</sup> ed., London: Sweet & Maxwell, 2005), sections 2.16-2.20; HM Treasury, *PFI: strengthening long-term partnerships* (London: Treasury, 2006), at <[http://www.hm-treasury.gov.uk/d/bud06\\_pfi\\_618.pdf](http://www.hm-treasury.gov.uk/d/bud06_pfi_618.pdf)> accessed 30 November 2010); National Audit Office, *Improving the PFI Tendering Process* (London: National Audit Office, 2007), at: <[http://www.nao.org.uk/publications/0607/improving\\_pfi\\_tendering.aspx](http://www.nao.org.uk/publications/0607/improving_pfi_tendering.aspx)> accessed 30 November; National Audit Office, *Making Changes in Operational PFI Projects* (London: National Audit Office, 2008), at: <[http://www.nao.org.uk/publications/0708/making\\_changes\\_operational\\_pfi.aspx](http://www.nao.org.uk/publications/0708/making_changes_operational_pfi.aspx)> accessed 30 November 2010

<sup>345</sup> Council Directive 2004/18 of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts OJ L134/114-240 (classic sector), Article 1(2) (a); and Council Directive 2004/17 of 31 March 2004 coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors OJ L134/1-113 (utilities sector), Article 1(2) (a).

and/or bodies which offer on the market, respectively, the execution of works and/or a work, products or services'.<sup>346</sup>

Public contracts can be further divided into works, supply and service contracts. Works contracts are contracts for carrying out works or a work. A works contract also covers a contract for procuring 'by any means' a complete work to the authority's specification. This brought within the directive contracts under which an authority appoints a firm to let contracts as agent on behalf of the authority. It also covers contracts under which a developer or landowner builds on land not owned by the authority, but to specifications set by the authority, and then transfers the land. A supply contract is one for the acquisition (purchase, lease etc) of products. The concept of a services contract covers procurement contracts which are not works or supply contracts, and have as their object services listed in Annex II of the directive.

The main rules that apply to the three different types of public contracts are almost identical. The directives apply the same framework of rules to all three types of contracts, leaving Member States to draw any appropriate distinctions between them – for example, over the types of award procedures suitable for different contracts. (Member States may also leave this to procuring entities, as the UK has done). There are, however, some differences between the different types, in particular:

- i) Much higher thresholds apply to works contracts than to supplies and services;
- ii) There are some differences in the availability of the negotiated procedure with a notice for the different types of contracts (see section 4.5 below); and
- iii) Some services contracts are not fully regulated but subject only to very limited obligations.

Services contracts are further divided into:

1. 'Priority' services, which are subject to the full rules under the directives, as outlined below, and

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<sup>346</sup> Directive 2004/18, Article 1(8); Directive 2004/17, Article 1(7) contains a similar provision referring to 'contracting entities' which include contracting authorities.

2. 'Non-priority' services, which are subject only to the rules on technical specifications, award notices (at the discretion of the purchaser), and certain obligations on provision of statistics. Categories of 'priority' services are listed in Annex IIA. This category includes things such as maintenance of vehicles and refuse collection, as well as professional services such as accountancy, IT services and consultancy. All those not listed, which includes, for example, legal and medical services, are non-priority. These rules are set out in Articles 20-21 of the Public Sector Directive. The priority services have been selected on the basis of the potential scope for cross-border trade; the potential savings; and the availability of information on the service. Contracts for both are classified as priority if the value of the consideration attributable to the priority services exceeds that of non-priority ones (Article 22).

Services are classified by comparing the activities to be undertaken with those listed under the relevant CPC codes, and not by looking at the purpose of the contract, as established by the ECJ in *Felix*.<sup>347</sup> That case arose out of proceedings before an Austrian review body relating to a contract awarded by the Austrian Central Bank for removal services. The Bank had considered that the full rules of the Services Directive did not apply, on the basis that the contract was a contract mainly for non-priority services, namely 'supporting and auxiliary transport services'. Swoboda challenged this view, claiming that the contract mainly involved various logistic and planning services relating to the move, and was, therefore, one for priority services. The ECJ ruled that it was necessary to classify the various services involved in the contract individually as belonging to the priority or non-priority categories, and to classify the contract as a whole according to their relative value, rejecting an alternative approach of identifying the 'main purpose' of the contract and then classifying the contract by reference to that purpose. In some cases what might appear naturally to be a single service must be broken down into its component activities for classification purposes. For example, in Case C-76/97 *Walter Tögel v Niederösterreichische Gebietskrankenkasse*, the ECJ ruled that the provision of services consisting of the transport of sick and injured persons with a nurse in attendance to provide

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<sup>347</sup> Case C-411/00 *Felix Swoboda v Osterreichische Nationalbank* [2002] ECR I-105670.

medical assistance contains both services within the priority category (the transport element, categorised as ‘land transport’) and services within the non-priority category (the medical element, categorised as ‘health and social services’). Such a contract must then be classified as either a priority or non-priority services contract according to the relative value of the different types of services.<sup>348</sup>

Some contracts are mixed in the sense that they contain work, supplies, and/or services in a single contract. Before 2004, there were no explicit provisions on mixed works/services contracts. However, the new Public Sector Directive contains an explicit provision on contracts containing both works and services, in Article 1(2)(d), third paragraph. This provides:

A public contract having as its object services within the meaning of Annex II and including activities within the meaning of Annex I that are only *incidental* to the principal object of the contract shall be considered to be a public service contract.

This makes it clear that, at least for cases in which the contract has a principal object, classification is to be based on a main object test rather than (as with priority/non-priority services contracts) a test based on the relative value of the services/works. However, it is not inconsistent with this new provision to apply a relative value test when the contract has no main object. This approach was confirmed by the ECJ, which stated that such a mixed contract is to be classified by considering the main purpose of the contract, and that the relative value of the works and the services is just one factor in determining the contract’s main purpose.<sup>349</sup>

Given the different treatment of various types of public contracts, it remains relevant to examine whether a particular PFI contract is works or service contract; and if a service contract, whether it is for priority or non-priority services.

As long as a PFI contract is not on non-priority services, the whole set of rules contained in the directives must be complied with. There is no room to discuss in detail here the rules on advertisement,

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<sup>348</sup> Case C-76/97 *Walter Tögel v Niederösterreichische Gebietskrankenkasse* [1998] ECR I-5357.

<sup>349</sup> Case C-412/04 *Commission v Italy*, ECJ judgment of 21 February 2008 (concerning the pre-2004 directives).

technical specification, selection and award criteria, and so forth.<sup>350</sup> Only the choice of procurement procedures that are most relevant to PPPs will be discussed below in section 4.5.

### **3.4 Other Contractual PPPs under the EU Treaty and general principles of EU law**

There are several possibilities that a public contract, other than a concession, may be outside the scope of directives:

- contracts the value of which are below the financial thresholds of the directives;
- non-priority services contracts; and
- contracts which the directive itself exempts from the obligations of advertising and competition (e.g. on grounds of urgency).

Such contracts were deliberately omitted from the directives, in part because it was considered that they are NOT always of interest to cross border trade. It is, therefore, unlikely that a PFI contract, normally of high value and long procuring period, will fall under any of these three categories. Nevertheless, should a contractual PPP falls outside of the coverage of the directives, the Treaty rules and positive obligations explained above in 4.3.2 are equally relevant.

The European Commission has set out its own views on what obligations apply to contract awards not or not fully subject to the provision of the Public Procurement Directives.<sup>351</sup>

According to the Commission, the obligations for most contracts include not just an obligation to advertise but also an obligation to hold a competition (although not necessarily a formal tender). According to the Commission the competition must be held in accordance with the general principle of equal treatment, similar to that of the directives (see further the section on equal treatment above), which includes requirements for things like reasonable time limits, disclosure of award criteria, etc. similar to those found in the

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<sup>350</sup> For a comprehensive guide on these rules, see S. Arrowsmith, *The Law of Public and Utilities Procurement* (2<sup>nd</sup> ed., London: Sweet & Maxwell, 2005).

<sup>351</sup> Commission (EC), 'Interpretative Communication on the Community law applicable to contract awards not or not fully subject to the provision of the Public Procurement Directives' (Communication) OJ C179/2, 23 June 2006.

directives – although it considers that not all of the rules in the directives will apply in the same way under the Treaty.

Even if there is no obligation to advertise and hold a competition in a particular case, the equal treatment principle will no doubt apply to govern the conduct of any competition that is held, and may again involve many obligations similar to those in the directives.

The Commission's views on this are controversial. The Communication has been the subject of a legal challenge by the German government for the reason, *inter alia*, that it involves 'legislation', which is beyond the powers of the Commission – the complaint is that the Commission is setting out detailed legal rules that have no foundation in the text or case law of the Treaty.<sup>352</sup> There has been extensive academic criticism of the transparency principle as developed in *Telaustria*.<sup>353</sup> The main criticisms are:

1. That it exceeds the bounds of acceptable judicial interpretation and amounts to legislative activity that undermines the proper division of responsibility between legislative and judicial branches of the EU (and is particularly inappropriate since the rules created are directly contrary to specific decisions of the legislature to exclude certain types of contracts from detailed regulation);
2. That it creates significant uncertainty for procuring entities, Member States and tenderers; and
3. Potentially, at least, it imposes unreasonable constraints on Member States' freedom of action to ensure value for money,

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<sup>352</sup> Case T-258/06 *Germany v Commission* [2006] O.J. C-294/52, noted by Brown in 'Case Comment: Case T-258/06: The German Challenge to the Commission's Interpretative Communication on Contracts not Subject to the Procurement Directives' (2007) 16 *Public Procurement Law Review* NA84.

<sup>353</sup> S. Arrowsmith, *The Law of Public and Utilities Procurement* (2<sup>nd</sup> ed., London: Sweet & Maxwell, 2005), at 4.16; A. Brown, 'Seeing Through Transparency: the European Court's Case Law on the requirement to Advertise Public Contracts and Concessions under the EC Treaty' (2007) 16 *Public Procurement Law Review* 1; P. Braun, 'A Matter of Principle(s): the Treatment of Contracts Falling Outside the Scope of the European Public Procurement Directives' (2000) 9 *Public Procurement Law Review* 39; P. Horijk and M. Meulenbelt, 'A Bridge Too Far: Why the European Commission's Attempts to Construct an Obligation to Tender outside the Scope of the Public Procurement Directives should be Dismissed' (2005) 14 *Public Procurement Law Review* 123; D. McGowan, 'Clarity at Last? Low Value Contracts and Transparency Obligations' (2007) 16 *Public Procurement Law Review* 274



etc. in the manner they think fit for contracts excluded by the directives – especially since judges are ill-suited to balance the different policy considerations involved in public procurement.

However, despite the criticism, the *Telaustria* line of case law has been confirmed by a Grand Chamber of the ECJ in *Coname*.<sup>354</sup>

#### 4. Coverage of IPPPs by EU Public Procurement Rules<sup>355</sup>

IPPPs are understood by the Commission as ‘a co-operation between public and private parties involving the establishment of a mixed capital entity which performs public contracts or concessions’.<sup>356</sup> The private input to the IPPP consists – apart from the contribution of capital or other assets – in the active participation in the operation of the contracts awarded to the public-private entity and/or the management of the public-private entity. Conversely, simple capital injections made by private investors into publicly owned companies, do not constitute IPPP.

In practice, an IPPP is usually set up:

- either, by founding a new company, the capital of which is held jointly by the contracting entity and the private partner – or, in certain cases, by several contracting entities and/or several private partners – and awarding a public contract or a concession to this newly founded public-private entity;
- or, by the participation of a private partner in an existing publicly owned company which has obtained public contracts or concessions ‘in-house’ in the past.

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<sup>354</sup> Case C-231/03 *Consorzio Aziende Metano (Coname) v Comune di Cingia de’ Botti* [2005] E.C.R. I-7287.

<sup>355</sup> See, in general, C. D. Tvarno, ‘A critique of the Commission's interpretative communication on Institutionalised Public-Private Partnerships’ (2009) 18 *Public Procurement Law Review* NA11-23; R. Williams, ‘The Commission Interpretative Communication on the Application of Community Law on Public Procurement and Concessions to Institutionalised Public Private Partnerships (IPPPs)’ (2008) 17 *Public Procurement Law Review* NA115

<sup>356</sup> Commission (EC), ‘Interpretative Communication on the Application of Community Law on Public Procurement and Concessions to Institutionalised Public-Private Partnerships (PPP)’ (Communication) C (2007) 6661, 5<sup>th</sup> February 2008.

The coverage of IPPPs by EU public procurement rules is even more complex since the application of the so-called ‘in-house providing’ exception, and affiliated undertaking exception, also need to be considered.

#### **4.1 IPPPs under EU Public Procurement Rules**

If the task assigned to the public-private entity is a public contract fully covered by the Public Procurement Directives, the procedure for selecting the private partner is determined by these Directives. If the task is a works concession or a public contract that is only partially covered by the Directives, the fundamental principles derived from the EC Treaty apply in addition to the relevant provisions of the Directives. In cases of services listed in Annex II B of Directive 2004/18/EC, the fundamental principles of the EC Treaty, as set out in Articles 49 and 56 TFEU, apply if these contracts can be expected to be of a certain interest to undertakings located in a different Member State to that of the relevant contracting entity. Finally, if it is a service concession or a public contract not covered by the Directives, the selection of the private partner has to comply with the principles of the EC Treaty. Therefore, the discussion below in section 4.3 remains relevant in the context of IPPPs.

It is noteworthy though that the Commission does not consider a double tendering procedure — one for selecting the private partner to the IPPP and another one for awarding public contracts or concessions to the public-private entity — to be practical.<sup>357</sup>

#### **4.2 IPPPs and ‘in-house providing’ exception**

When the public entities in question are legally unified, i.e. forming part of the same department, the ECJ has clarified that there will be no public contract involved and therefore no need to apply procurement

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<sup>357</sup> Commission (EC), ‘Interpretative Communication on the Application of Community Law on Public Procurement and Concessions to Institutionalised Public-Private Partnerships (PPP)’ (Communication) C (2007) 6661, 5<sup>th</sup> February 2008., at 2.2

rules.<sup>358</sup> The underlying rationale is that the procuring public entity should have...

the possibility of performing the tasks conferred on it in the public interest by using its own administrative, technical and other resources, without being obliged to call on outside entities not forming part of its own departments.<sup>359</sup>

Therefore, the ECJ put a limit on the application of EU procurement rules excluding purely ‘in-house’ procurement. This exception has far reaching impact on setting up IPPPs.

The scope of this exception depends on how big the ‘house’ is. Apart from two branches from the same government department, can two government departments, legally distinct from each other but nonetheless affiliated to the same State, be regarded as being ‘in the same house’? It is apparent that different States have contradicting views on this. On the one hand, the Norwegian Ministry of Modernisation argued that ‘the state must be regarded as one legal person, and that it should be able to procure supplies and services from its own departments and directorates without competition’; on the other hand, Denmark only regards purchasing arrangements within the same sphere of authority as in-house procurement.<sup>360</sup> It is observed that in the Swedish courts, all government authorities are considered as being part of the same legal entity regardless of how independently they may act, while municipalities and county councils are considered to be separate legal entities.<sup>361</sup>

The ECJ has made it clear that the ‘house’ can neither be as big as equating with the State nor be as small as within one legal entity, in

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<sup>358</sup> Case C-26/03, *Stadt Halle, RPL Recyclingpark Lochau GmbH v Arbeitsgemeinschaft Thermische Restabfall- und Energieverwertungsanlage TREA Leuna* [2005] E.C.R. I-0001, at para. 48.

<sup>359</sup> *ibid.*

<sup>360</sup> Letter from the Ministry of Modernisation of 18 January 2005 to the Ministry of Finance regarding the state's centre for economic governance and its participation in procurement procedures. This was quoted in K. Weltzien, ‘Avoiding the Procurement Rules by Awarding Contracts to an In-house Entity-Scope of the Procurement Directives in the Classical Sector’ (2005) *Public Procurement Law Review* 237 at 238. Canada takes a view similar to that of the Norwegian Ministry of Modernisation.

<sup>361</sup> K. Pedersen and E. Olsson, ‘Commission v Germany - a new approach to in-house providing?’ (2010) *Public Procurement Law Review* 33-46, at 41.

the landmark *Teckal* case.<sup>362</sup> As a starting point, in the absence of an express exception,<sup>363</sup> the ECJ ruled that it is sufficient in principle, for a public contract to exist, that the contract has been concluded between ‘two separate persons’,<sup>364</sup> or ‘a local authority on the one hand and a person legally separate from the latter on the other hand’.<sup>365</sup> However, purchasing arrangements between two legally distinct public entities may nevertheless be outside the scope of EU procurement rules in the case where the contracting authority exercises over the supplying public entity:

a control which is similar to that which it exercises over its own departments and, at the same time’, the supplying public entity ‘carries out the essential part of its activities with the controlling local authority or authorities.’<sup>366</sup>

Therefore, through *Teckal* and a long line of subsequent case law,<sup>367</sup> the ECJ has established, and continues to fine-tune, one of most significant exceptions to the EU procurement rules - the so called ‘in-

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<sup>362</sup> Case C-107/98 *Teckal Srl v Comune di Viano (Reggio Emilia)* [1999] E.C.R. I-8121.

<sup>363</sup> The available express exceptions are addressed below.

<sup>364</sup> Case C-107/98 *Teckal Srl v Comune di Viano (Reggio Emilia)* [1999] E.C.R. I-8121, at para. 49-50.

<sup>365</sup> Case C-349/97 *Commission v Spain* [2003] E.C.R. I-3851 at para. 204.

<sup>366</sup> Case C-107/98 *Teckal Srl v Comune di Viano (Reggio Emilia)* [1999] E.C.R. I-8121, at para. 50.

<sup>367</sup> Case C-107/98 *Teckal Srl v Comune di Viano* [1999] ECR I-8121; Case C-94/99 *ARGE Gewässerschutz v Bundesministerium für Land- und Forstwirtschaft* [2000] ECR I-11037; Case C-349/97 *Commission v Spain* [2003] ECR I-3851; Case c-26/03 *Stadt Halle* [2005] ECR I-0001; Case C-84/03 *Commission v Spain* [2005] ECR I-139; Case C-231/03 *Consorzio Aziende Metano (Coname) v Comune di Cingia de'Botti* [2005] ECR I-7287; Case C-458/03 *Parking Brixen GmbH v Gemeinde Brixen, Stadtwerke Brixen AG* [2005] ECR I-8585; Case C-29/04 *Commission v Austria (Mödling)* [2005] ECR I-9705; Case C-410/04 *Associazione Nazionale Autotrasporto Viaggiatori (ANAV) v Comune di Bari, AMTAB Servizio SpA* [2006] ECR I-3303; Case C-340/04 *Carbotermo v Comune di Busto Arsizio* [2006] ECR I-4137; Case C-220/05 *Jean Auroux v Commune de Roanne* [2007] ECR I-385; Case C-337/05 *Commission v Italy (Augusta Bell Helicopters)* [2008] ECR I-2173; Case C-220/06 *Asociación Profesional de Empresas de Reparto y Manipulado de Correspondencia v Administración General del Estado* [2007] ECR I-12175; Case C-295/05 *Asemfo v Tragsa* [2007] ECR I-2999; Case C-324/07 *Coditel Brabant SA v Commune d'Uccle and Région de Bruxelles-Capitale*, Judgement of 13 November 2008.

house providing' exception. The exception is twofold. Firstly, it excludes from the application of procurement rules purely 'in-house' contracts - those performed with a contracting authority's own internal resources. Secondly, it also excludes 'quasi-in-house' arrangements - contracts performed by a public entity legally distinct from the contracting authority but i) under its control, similar to that which it exercises over its own departments and, at the same time, ii) the in-house provider must carry out the essential part of its activities with the controlling contract authority or authorities. Whenever both requirements are met, the services are awarded on account of the control exercised by a public authority over a provider who is only 'formally' and not 'substantially' a third party; whose mission is to provide services for its controller, or on behalf of it, regardless of the fact that the provider is subject to public or private law; and established pursuant to contract, statute, regulation or administrative provisions. While the exclusion of purely in-house procurement can arguably be derived from the definition of public contracts contained in the Directives, the exclusion of 'quasi-in-house' arrangements does not have formal legal basis in the procurement Directives and has encountered difficulties in its codification.

Attention can now be turned towards the detailed analysis of the two cumulative conditions required for the 'in-house providing' exception to apply, namely the 'similar control' test and the 'essential part of its activities' destination' test as interpreted by the constantly refining case law. It can be argued that these conditions have been interpreted by the ECJ, in many respects, in such a way as to make it difficult to rely on the in-house provision.

#### **4.2.1 The 'Similar Control' Test**

The 'similar control' requirement provides that the in-house provider 'has no discretion' whatsoever and that, in the end, the public authority is the only one to make decisions concerning that company. Moreover, use of the expression 'in-house' indeed reveals the intention to make a distinction between activities which the authority carries out directly – by means of internal structures 'belonging to the house' – and those that it will entrust to a third-party operator.<sup>368</sup>

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<sup>368</sup> Opinion of Advocate General Bot in Case C-220/06 *Asociación Profesional de Empresas de Reparto y Manipulado de Correspondencia v Administración del Estado* [2007] ECR I-12175, at 75.

The ‘similar control’ requirement identifies the powers of influence required by the parent contracting authority in order to fully pursue ‘its public interest objectives’, regardless of whether this influence is exercised by means of private or public law powers, or by means of a single power or the joint effects of different powers.

Therefore, the ‘similar control’ requirement represents the parent public authority’s ability to make the most relevant decisions on the management and manufacturing process of the in-house provider, thus excluding a bilateral negotiation on terms and conditions of the supply of works, products or services. This ‘similar control’ implies the power of the parent contracting authority to set unilaterally – in pursuing its own (public) interests – the manufacturing and supplying conditions to the extent of precluding full management discretion on the part of the in-house provider.<sup>369</sup> The right of the provider to put an end to the contract with the contracting authority at any time seems to have been considered to be a decisive factor in not finding an in-house arrangement.<sup>370</sup>

It appears that the ‘similar control’ requirement, as developed by ECJ case law, does not imply a direct shareholding of the controlling authority in the in-house provider’s capital. Sometimes, the intervention of an intermediary holding company ‘may, depending on the circumstances of the case, weaken any control possibly exercised by the contracting authority’,<sup>371</sup> whereas at other times, the intermediary holding company is not relevant to the determination of whether the ‘similar control’ requirement is met.<sup>372</sup>

When the in-house provider’s capital is wholly owned by the controlling authority that appoints it to carry out its services, this 100 per cent shareholding, in the absence of evidence to the contrary, is an indication that the ‘similar control’ requirement is met, especially where the in-house provider carries out all of its activity solely for the

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<sup>369</sup> Case C-295/05 *Asociación Nacional de Empresas Forestales (Asemfo) v Transformación Agraria SA (Tragsa)* [2007] ECR I-2999, at 59.

<sup>370</sup> Case C-220/06 *Asociación Profesional de Empresas de Reparto y Manipulado de Correspondencia v Administración del Estado* [2007] ECR I-12175.

<sup>371</sup> Case C-340/04 *Carbotermo, Consorzio Alisei v Comune di Busto Arsizio* [2006] ECR I-4137, at 39.

<sup>372</sup> Opinion of Advocate General Sixt-Hackl in Case C-26/03 *Stadt Halle and RPL Lochau GmbH v TREA Leuna* [2005] ECR I-0000, at 6-10, 59.

controlling authority.<sup>373</sup> The absence of other shareholders permits the presumption of a lack of ‘external’ interests that may prevent the controlling authority from pursuing the public interests within this in-house context.

In a situation where a group of contracting authorities holds shares in the in-house provider’s capital, a deeper examination as to whether the powers of influence in the in-house entity management entitle each contracting authority to exert a ‘similar control’ over it is required, insofar as only some of the shareholding authorities might exercise a ‘similar control’, while others may not participate in the in-house relationship, thus being unable to dispose of direct awards to the in-house organisation in compliance with EC law.<sup>374</sup> An excessive fragmentation of capital shareholdings does not prevent each shareholder from exerting a ‘similar control’; it only requires an in-depth analysis of whether the minority shareholders are entitled to influence the provider’s decision-making<sup>375</sup>.

The holding of in-house provider capital shares by entities other than the parent public authorities introduces economic interests which may affect and interfere with the exercise of ‘similar control’ by the parent public authorities, thus harming the pursuit of the above-mentioned public interests.<sup>376</sup> The actual presence of a third-party private shareholder must be considered when ascertaining whether the ‘similar control’ requirement is met; if satisfied, the relationship

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<sup>373</sup> See Opinion of Advocate General Kokott in Case C-458/03 *Parking Brixen GmbH* Case C-458/03 *Parking Brixen GmbH v Gemeinde Brixen, Stadtwerke Brixen AG* [2005] ECR I-8585, at 74-75.

<sup>374</sup> Case C-107/98 *Teckal v Comune di Viano* [1999] ECR I-8121; Case C-231/03 *Consorzio Aziende Metano (Coname) v Comune di Cingia de'Botti* [2005] ECR I-7287; Opinion of Advocate General Cosmas in Case C-107/98 *Teckal v Comune di Viano* [1999] ECR I-8121, at 16.

<sup>375</sup> Case C-324/07 *Coditel Brabant SA v Commune d'Uccle and Région de Bruxelles-Capitale*, Judgement of 13 November 2008, at 31; Case C-340/04 *Carbotermo, Consorzio Alisei v Comune di Busto Arsizio* [2006] ECR I-4137, at 37 and Case C-295/05 *Asociación Nacional de Empresas Forestales (Asemfo) v Transformación Agraria SA (Tragsa)* [2007] ECR I-2999 at 57.

<sup>376</sup> Advocate General Kokott in her Opinion in Case C-458/03 *Parking Brixen GmbH* Case C-458/03 *Parking Brixen GmbH v Gemeinde Brixen, Stadtwerke Brixen AG* [2005] ECR I-8585, at 74, argued that ‘if a private third party has a holding, even a minority holding, in an undertaking, the consideration given to the economic interests of that undertaking may prevent the public body from fully pursuing its public-interest objectives’.

between the awarding contracting authority and the public-private company would fall within the in-house exception under EC law<sup>377</sup>.

According to ECJ case law, the ‘similar control’ condition fades if the private minority shareholder acquires considerable rights of veto over important decisions, or the power to appoint one of two managing directors having identical rights,<sup>378</sup> or whenever the by-laws decree a wide breadth of business objectives, the possibility of expansion of the geographical scope of a company’s activities to the whole of a national and foreign territory and the opening of the company to other capital.<sup>379</sup> Equally, it seems that the ‘similar control’ requirement will not be met by the mere holding of majority in a company’s general assembly or the power to appoint more than half of the managerial or administrative board members – irrespective of whether this power is provided for by the company by-laws or by a corporate agreement – where the managing director is appointed by the private minority shareholders.<sup>380</sup> A shareholders agreement or the applicable national company law may render the majority shareholder powers of control ineffective, binding, or limiting the power to appoint the managerial board or narrowing the managing director’s

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<sup>377</sup> In Case C-26/03 *Stadt Halle and RPL Lochau GmbH v TREA Leuna* [2005] ECR I-0000, at 19, the circumstances that the private minority shareholder had ‘certain specific rights’ seemed to be decisive.

<sup>378</sup> Such powers, entitled to the private shareholder, prevent the City of Mödling from exerting a ‘similar control’ even if the latter has the majority of votes in the general assembly: Opinion of Advocate General L.A. Geelhoed in Case C-29/04 *EC Commission v Austria* [2005] E.C.R. I-9700, at 36, 39 and 46.

<sup>379</sup> Case C-458/03 *Parking Brixen GmbH* Case C-458/03 *Parking Brixen GmbH v Gemeinde Brixen, Stadtwerke Brixen AG* [2005] ECR I-8585, at 65-7.

<sup>380</sup> Unless the public authorities were entitled to exert decisive management instruction over the in-house entity: Case C-94/99 *ARGE Gewässerschutz v Bundesministerium für Land-und Forstwirtschaft* [2000] ECR I-11037, commented by M. Ohler, ‘The Position of Semi-Public Tenderers in an Award Procedure under the E.C. Procurement Directives: A Note on Case C-94/99’ (2001) *Public Procurement Law Review* NA54; Case C-29/04 *E.C. Commission v Austria* [2005] ECR I-9705; Case C-458/03 *Parking Brixen GmbH* Case C-458/03 *Parking Brixen GmbH v Gemeinde Brixen, Stadtwerke Brixen AG* [2005] ECR I-8585, at 64.



discretion, thus blunting public authority influence<sup>381</sup> on the in-house provider's strategic objectives and significant decisions.<sup>382</sup>

The 'similar control' exercised over the in-house provider must be effective, but it need not be exercised individually. Therefore, where a number of public authorities own a sole in-house provider organisation, to which they entrust the performance of one of their tasks, the control which those public authorities exercise over that entity may be exercised jointly.<sup>383</sup> It follows that the form of pure co-operation or association among local authorities taken by the in-house provider must be evaluated in conjunction with the effective 'similar control' exercised by the awarding authority: the 'similar control' requirement is thus met when the contracting authorities enjoy detailed powers of influence over the in-house provider, sufficient to support a finding of an in-house provision relationship.<sup>384</sup>

#### **4.2.2 The destination of the essential part of an in house provider's activities**

The in-house provider must carry out the essential part of its activities for its parent and controlling public authority, thus limiting its economic freedom and autonomy as an enterprise and market competitor, in the sense that only a very small portion of its activities can be pursued outside the in-house relationship, in order to reap the benefit of economies of scale and scope.<sup>385</sup>

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<sup>381</sup> Case C-26/03 *Stadt Halle and RPL Lochau GmbH v TREA Leuna* [2005] ECR I-0000, at 19 where 'the private minority shareholding exceeded the threshold of 10 per cent above which, in accordance with the German legislation on limited companies, there is a minority with certain specific rights'.

<sup>382</sup> Case C-324/07 *Coditel Brabant SA v Commune d'Uccle and Région de Bruxelles-Capitale*, Judgement of 13 November 2008, at 34; Case C-458/03 *Parking Brixen GmbH* Case C-458/03 *Parking Brixen GmbH v Gemeinde Brixen, Stadtwerke Brixen AG* [2005] ECR I-8585, at 65; Case C-340/04 *Carbotermo, Consorzio Alisei v Comune di Busto Arsizio* [2006] ECR I-4137, at 38.

<sup>383</sup> M. Dischendorfer, 'The compatibility of contracts awarded directly to "joint executive services" with the Community rules on public procurement and fair competition' (2007) *Public Procurement Law Review* NA129.

<sup>384</sup> Case C-371/05 *EC Commission v Italy*, judgment of 17 July 2008, at 25; Case C-324/07 *Coditel Brabant SA v Commune d'Uccle and Région de Bruxelles-Capitale*, Judgement of 13 November 2008, at 41.

<sup>385</sup> R. Cavallo Perin and D. Casalini, 'In house providing: un'impresa dimezzata' (2006) *Diritto Amministrativo* 51. According to F. Avarkioti, 'The application of EU public procurement rules to "in house" arrangements' (2007) *Public Procurement Law Review* 22, at 33: 'there is no fear that such undertaking may

The wording of the examined criterion is not univocal in ECJ decisions and in the Advocate General's Opinions, where it is referred to as the 'main part' as well as the 'essential part' of the activities carried out by the in house provider.<sup>386</sup> It follows that any other activity towards third entities may only be of accessory, ancillary, secondary, or marginal significance. Notwithstanding some uncertainty in assessing the criteria eligible to meet this requirement, there are some fixed points in its still developing interpretation.

The starting point in assessing the requirement should be the activities effectively performed by the in-house provider, as opposed to the potential activities which another third entity could undertake – according to the law, its own by-laws, or the act of delegation issued by the controlling authorities – which should not form the basis of calculation. Therefore, in cases of several controlling authorities, the activities to be taken into account are those effectively carried out for all of these authorities taken together.<sup>387</sup>

Moreover, the measurement of the main or essential part of the in-house provider's activity has to be performed both from a qualitative and quantitative point of view. Considering the qualitative perspective, it seems to be necessary to examine what kind of tasks the company is entitled to carry out. It is doubtful whether the circumstances that the provider is operating in a competitive market or that it is carrying out entrusted tasks based on a concession or delegation which transfers a granted and protected demand to the provider could be relevant, as the ECJ has clearly stated that it does not matter who is the beneficiary (the contracting authority or the users); who pays for the services (the contracting authority or the customers); and where those services are provided<sup>388</sup>.

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compete (in favourable terms) with other undertakings in tender procedures for public contracts'.

<sup>386</sup> F. Avarkioti, 'The application of EU public procurement rules to "in house" arrangements' (2007) *Public Procurement Law Review* 22, at 32; T. Kaarresalo, 'Procuring in-house: the impact of the E.C. procurement regime' (2008) *Public Procurement Law Review* 242, at 252.

<sup>387</sup> Case C-340/04 *Carbotermo, Consorzio Alisei v Comune di Busto Arsizio* [2006] ECR I-4137, at 69-72; Case C-295/05 *Asociación Nacional de Empresas Forestales (Asemfo) v Transformación Agraria SA (Tragsa)* [2007] ECR I-2999, at 65; C-324/07 *Coditel Brabant SA v Commune d'Uccle and Région de Bruxelles-Capitale*, Judgement of 13 November 2008, at 27; Case C-371/05 *EC Commission v Italy*, judgment of 17 July 2008.

<sup>388</sup> Case C-340/04 *Carbotermo, Consorzio Alisei v Comune di Busto Arsizio* [2006] ECR I-4137

From a quantitative perspective, the income or turnover of the entity turns out to be decisive in assessing the essential part of the in-house provider's activities: considering all the activities performed, those awarded by the controlling authorities must be predominant. To that extent, it appears impossible to define a percentage threshold in advance as a general rule to apply automatically; a case by case approach seems more suitable.

The destination of the essential part of the in-house provider's activities is meant to express a very close functional and economic dependence of the latter on the controlling authorities so that the repeal of the entrusting of works, products and services deprives the in-house provision relationship of its own consideration and averts the in-house provider's permanence as an economic operator, even on the markets where it used to carry out subsidiary or secondary activities.

#### **4.3 IPPPs and 'Affiliated Undertakings' and 'Joint Venture' Exemptions in the Utility Sector Directive<sup>389</sup>**

The Utilities Directive (2004/17) contains an additional provision (Article 23), excluding from the application of the utility Directive only:

- i) contracts awarded by a contracting entity or a joint venture formed exclusively by such entities to carry out a utility activity, towards an affiliated undertaking (the so-called 'affiliated undertaking exemption');
- ii) contracts awarded by such a joint venture to one of its partners, as well as contracts awarded by a contracting entity to such a joint venture, of which it forms part (the so-called 'joint venture exemption').

Both are relevant to IPPPs.

For the 'affiliated undertaking exemption' to apply, two cumulative criteria must be fulfilled. The first is the requirement of an 'affiliation' (Article 23(1)). An undertaking will be regarded as affiliated to a contracting entity if:

- i) its annual accounts are consolidated with those of the contracting entity; or
- ii) the contracting entity has control over the undertaking; or

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<sup>389</sup> See S. Arrowsmith, *The Law of Public and Utilities Procurement* (2nd ed., London: Sweet & Maxwell, 2005), at 15.13.9.

- iii) the undertaking has control over the contracting entity; or
- iv) both are subject to the control of another undertaking.

It is noteworthy that the 'control' test here means dominant influence by virtue of ownership, financial participation, or the rules which govern it. This test differs significantly from the 'similar control' test in the 'in-house providing' exception in the sense that the control test to establish affiliation includes reverse control and mutual third party control, and is much easier to fulfil.

The second criterion is the so-called '80 per cent rule' (Article 23(2)). It requires that at least 80 per cent of the average turnover of the affiliated undertaking with respect to services, supplies or works, depending on the contracts being considered for exclusion in question, for the preceding three years derives from the provision of such services, supplies or works, to undertakings with which it is affiliated. This criterion also differs from the 'destination of the essential part of activities' test in the 'in-house providing' exception discussed above, in the sense that the '80 per cent rule' test is more straightforward and, arguably, easier to fulfil.

The European Commission is empowered to monitor the application of both the 'affiliated undertaking exemption' and the 'joint venture exemption', by requiring the undertakings concerned to notify the nature and the value of the contracts involved (Article 23(5)).

## **5. Award Procedure and PPPs**

As noted by the Commission, in awarding PPPs contracts that are fully covered by the Public Sector Directive, the open and restricted procedures defined in that Directive may, due to the particular financial or legal complexity of such contracts, not offer sufficient flexibility. For cases like this, the Public Sector Directive introduced a new innovative procedure – the competitive dialogue – the aim of which is not only to preserve competition between economic operators, but also to take into account the contracting authorities' need to discuss all aspects of the contract with each candidate. It is still possible to award public contracts fully covered by the Public Sector Directive through the negotiated procedure with publication of a contract notice; however, its use is limited to exceptional cases.

## 5.1 Competitive Dialogue<sup>390</sup>

Competitive dialogue is a new procedure introduced for the first time in the Public Sector Directive to provide more flexibility in procedures for complex contracts. The need for more flexible procedures was perceived in the United Kingdom since at least the late 1980s, most notably for contracts under the PFI. The reason for the introduction of this new procedure was the need of Member States PFI projects, and, also, the EU's own policy of promoting PPP for European transport infrastructure. Open and restricted procedures are unsuitable for many such projects for a number of reasons, including: their limits on iterative procedures, in particular for eliminating participants during the procedure through discussions/outline tenders; the need for at least 5 tenderers in restrictive procedures, which is disproportionate in high-cost PFI procedures; and the limited scope for post-tender dialogue in these procedures. The negotiated procedure with a notice is suitable, but there remained some uncertainty over whether it was available for PFI projects; the European Commission had cast doubt on the UK practice of using the negotiated procedure with a notice in the context of PFI.

There are a number of sources of guidance on this procedure:

1. From the Commission (EC) , *Explanatory Note – Competitive Dialogue – Classic Directive* (2005), available at <<http://simap.eu.int>> (accessed 30 November 2010). This is useful, in particular, for indicating some uses and practices that Commission staff consider to be acceptable.

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<sup>390</sup>See S. Arrowsmith, *The Law of Public and Utilities Procurement* (2nd ed., London: Sweet & Maxwell 2005), Chapter 10; A. Brown, 'The Impact of the New Directive on Large Infrastructure Projects: Competitive; Dialogue or Better the Devil You Know' (2004) 13 *Public Procurement Law Review* 160; C. Kennedy-Loest, 'What Can be Done at the Preferred Bidder stage in Competitive Dialogue?' (2006) 15 *Public Procurement Law Review* 317; A. Rubach-Larsen, 'Competitive Dialogue', in R. Nielsen and S. Treumer (eds.), *The New EU Public Procurement Directives* (Copenhagen: Djøf 2005); P. Trepte, *Public Procurement in the EU: a Practitioner's Guide* (Oxford: OUP 2007), p. 445-453; S. Treumer, 'Competitive Dialogue' (2004) 13 *Public Procurement Law Review* 178; S. Treumer, 'The Field of Application of Competitive Dialogue' (2006) 15 *Public Procurement Law Review* 307; S. Verschuur, 'Competitive Dialogue and the Scope for Discussion after Tenders and Before Selecting the Preferred Bidder—What is Fine-Tuning Etc?' 15 *Public Procurement Law Review* 327.

2. In the UK, HM Treasury has recently produced guidance covering both legal and strategic considerations in using competitive dialogue that takes into account the early experience of the procedure in the UK: HM Treasury, Competitive dialogue in 2008, July 2008, available at <[www.ogc.gov.uk](http://www.ogc.gov.uk)> (joint Treasury/OGC publication) (accessed 30 November). There was also other guidance issued when the procedure was first implemented in the UK that is still relevant, such as: Competitive Dialogue Procedure: OGC Guidance on the Competitive Dialogue Procedure in the new Procurement Regulations, Jan 2006; and the guidance Practical Guidance on the Use of Competitive Dialogue, July 2006. There is also various other guidance such as sector-specific guidance which is referred to on the website above and (as it existed at that time) listed in the 2008 guidance referred to above also.

Many states that have implemented Directive 2004/18 have included the competitive dialogue procedure. In general, states have simply added the procedure to their laws largely in the form that it appears in the Directive itself, without elaborating on the way in which it is to be applied by contracting authorities beyond what is stated in the Directive itself – for example, they have not put in place detailed rules on how the ‘dialogue’ phase is to be conducted by contracting authorities. This applies not only in states whose traditional approach is to simply copy out the directives – for example, the United Kingdom – but also to other states which have traditionally regulated procurement procedures through their own rules (such as Spain). An exception is Portugal, which has adopted its own precisely elaborated version of the procedure.

The United Kingdom has been the largest user of the competitive dialogue procedure so far. This is not surprising since it is a large member state and the procedure quite closely reflects previous UK practice in awarding major infrastructure projects under the old negotiated procedure (although there are important differences – notably the need for a fully complete tender at final tender stage in the competitive dialogue procedure). By the end of August 2009, there had been well over 1500 procedures advertised in the *Official Journal*. Other significant users of the procedure include France, Germany, Poland, and (especially in proportion to its size) Denmark. On the other hand, some states that have the procedure in their laws have not

yet used it, or used it only in a very few cases (e.g. Lithuania and Portugal).

### 5.1.1 Grounds for using the procedure

The procedure is available for ‘particularly complex contracts’. These are defined as contracts for which the entity is ‘objectively’ unable to define the technical means capable of satisfying its objectives, or to specify the legal and/or financial make-up of the project.<sup>391</sup> These grounds appear to overlap with, but in some respects are broader than, the situations covered by the negotiated procedure.

It can be argued that this refers to the case in which the authority is unable to find the *best* solution itself. This can be deduced from the fact that the purpose of the dialogue is stated to be to enable the authority to identify the means *best* suited to its needs, as stated in Article 29(3) of the Directive – thus a reading of Article 1(9) in context suggests that this is the appropriate interpretation.

An authority may also only use the competitive dialogue procedure to award a complex contract as defined above where it ‘considers that the open or restricted procedure will not allow the award’ (Article 29(1) of the Directive).

Unfortunately, the legislation does not make clear whether competitive dialogue is an exceptional procedure that is to be interpreted and applied strictly (like the negotiated procedure without a notice – as discussed further below), or a ‘standard’ procedure like the open and restricted procedures. This could be very important in interpreting the extent of the provision. For example, this could be relevant to answering many of the questions discussed in the literature, such as whether it can be used in cases where using other approaches would involve excessive costs; and, also, whether the suggestion above is correct that the procedure can be used to allow the authority to determine what is the *best* solution.

The grounds for using this procedure have not yet been subject to judicial interpretation and their precise meaning, therefore, remains a matter for theoretical debate.

The main cases in which the procedure has been commonly used in the UK in practice, are:

1. Privately financed infrastructure projects. However, as guidance from the OGC emphasises, the procedure cannot be

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<sup>391</sup> Article 1(9) of Directive 2004/18

used simply because the project is of this type – it is necessary to consider why the conditions for its use are met in the specific case.

2. Where an authority is seeking to install a complex bespoke information technology (IT) system to deal with a new problem, for which IT has not been used before. The authority may not be able to draw up a precise specification because it does not know what type of system would work best, or how it should best be operated – for example, what sort of functions can and cannot be carried out by the system; how easily it can be integrated with other systems operated by the authority; or whether it should be operated by the private contractor, or by the authority's own employees. Thus it may be appropriate to issue just a broad description of the function of the system, and leave tenderers to propose their own specifications based on their knowledge and technical capabilities.

Whatever the nuances of the legal rules, a very important point to consider when using this procedure is the value of a clear audit trail that shows:

- i) that the procuring entity has addressed its mind to the relevant conditions; that is, whether the definition of a particularly complex contract is met, and whether the open or restricted procedure could be used; and
- ii) that it has some good evidence that these conditions are met (which should be recorded).

This should point to matters specific to the project, and not just repeat the wording of the directive that the authority is not able to define the technical means, etc. For example, the documentation will need to explain *why* the procuring entity cannot define the technical means. In a project for providing a school, for example, this might be because the procuring entity does not know what sites of their own, if any, potential tenderers can offer for the school, and/or what the merits of different possible solutions are (for example, use of tenderer's own sites; refurbishing existing buildings on an existing site; demolishing existing buildings and building on the new site; or using other land owned by the authority).

Such an audit trail can help defend the procuring entity against challenges and reduce the likelihood of a challenge being successful.



### **5.1.2 The rules of the competitive dialogue procedure**

The procedure to be followed in competitive dialogue is set out in Article 29 of Directive 2004/18. The form of the procedure and its different phases are specified in more detail than in the negotiated procedure. An example of one way in which it is very often applied in practice in the UK is set out below in the diagram, *Competitive dialogue procedure: a common approach in the UK*.

It should be noted that, to a large extent, the rules that apply in the different phases (e.g. selection and award) are the same as, or very similar to, those of the restricted procedure. There has, as yet, been no case law of the ECJ or the UK courts dealing with the interpretation of these rules on competitive dialogue – although there have been cases in some other EU Member States (e.g. Denmark).

### Competitive dialogue procedure: a common approach in the UK

	<b>COMPETITIVE DIALOGUE</b>
<b>ADVERTISING Phase</b>	Contract notice in O.J.
<b>SELECTION Phase (technical and/or professional ability; economic and financial standing; Article 45 criteria) Articles 44-52</b>	Suitability (Qualification)
	Selection of candidates to tender from suitable ones
<b>AWARD Phase (choice of lowest price or most economically advantageous tender [MEAT])  Article 53</b>	Dialogue Phase i) Outline proposals from e.g. 3-6 participants (often no or limited financial information) ii) Authority chooses e.g. 2-3 to submit further proposals iii) Discussion of proposals with the 2-3 chosen iv) Submission of detailed financial and technical proposals from the chosen 2-3 v) Further discussions if required
	Submission of final tenders by 2-3 tenderers
	Clarification, supplementation or fine-tuning of final tenders
	Choice of lowest price or MEAT (and notification to all tenderers)
<b>POST-TENDER Phase</b>	Clarification and confirmation stage with “preferred bidder”
<b>STANDSTILL Phase</b>	✓
<b>CONCLUSION of contract</b>	✓
<b>POST-CONTRACT</b>	Contract award notice

The above diagram illustrates the way in which competitive dialogue is often operated in practice in the UK in relation to privately financed infrastructure projects. Taking a typical example of a PFI project, one

to provide school facilities, the way in which the dialogue phase is structured can be explained as follows:

- i. Outline proposals from, e.g. 3-6 participants (often no or limited financial information).

The authority will first invite outline proposals from a limited number of suitable providers. These will set out providers' solutions for the project. For example, in the case of a school these might include (depending on the conditions laid down by the contracting authority): refurbishing an existing school on an existing site; demolishing the existing school and constructing a new one on the same site; or constructing a new school on other sites (which could be owned by the authority or by tenderers or others) and using the existing site for other purposes - these might generate revenue for the provider that can be used to enable it to offer favourable terms for providing the school or benefits for the authority. These proposals may or may not include some financial information (e.g. authorities may ask for some indication of this if the affordability of the project is in question).

- ii. Authority chooses e.g. 2-3 to submit further proposals.

Applying the pre-stated contract award criteria, the authority then selects a smaller number of providers to submit fuller proposals. The number tends to be limited, often to 2, because of the very cost of submitting fuller proposals. (For example, the authority might decide not to take forward some of the providers who are offering alternative sites for the school development because it does not consider that these sites are suitable, e.g. because of their distance from the catchment area, or because of access problems).

- iii Discussion of proposals with the 2-3 chosen.

There then follow discussions on the chosen 2-3 providers' outline proposals so that they can refine their basic proposals, e.g. to better adjust them to the authority's priorities (e.g. to determine exactly what kind of services and facilities should be provided beyond those specified as essential), and the applicable contract terms can be developed.

- iv. Submission of detailed financial and technical proposals from the chosen 2-3

It is then common, prior to the formal final tender stage, for providers to first submit fully detailed and costed proposals that are not treated as the final tenders under the

directive/regulations. This ensures that no problems emerge in the final tenders, given that the scope for adjustment after the formal final tender stage in the directive is both limited and uncertain.

v. Further discussions if required

Further discussions will then be held if needed, e.g. to consider how aspects of the full proposals that are not considered satisfactory to the authority can be amended.

The authority will then call formally for final tenders, which are fully detailed and costed proposals.<sup>392</sup>

Article 29(3) of the new directive states:

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 was inserted so that bidders are not deterred from participating by a fear that the public entity might reveal confidential information and, in particular, details of its proposed solutions that might be used by other tenderers.

It is not entirely clear whether Article 29(3) covers only information classified as confidential under domestic law (such that its disclosure would violate the provider's existing legal rights), or establishes an independent 'EU' requirement for confidentiality, especially insofar as a provider's 'solutions' are concerned. The Commission's Explanatory Note seems to take the former view. This leaves much uncertainty about what information is confidential and what information is not confidential under the provision. Clearly solutions might be based on 'ideas' that are not protected by any kind of intellectual property, some of which are obvious and some less so – and it is not clear which of these may and may not be used. There is no case law on this provision.

Another question is what is sufficient 'agreement' to exclude the confidentiality requirement. This clearly leaves it open for a

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<sup>392</sup> Fuller details of UK actual practice and what is considered 'good practice' in these projects can be found in HM Treasury, Competitive dialogue in 2008, July 2008, available at <[www.ogc.gov.uk](http://www.ogc.gov.uk)> (joint Treasury/OGC publication), accessed 30 November 2010.

participant to agree, for example, that all others should be asked to tender on the basis of that participant's solution (for example, in return for payment). It can also be argued that, if the authority makes it clear in the notice or contract documents that it reserves the right to reveal certain information and that this is a condition of participation, participants are, in this case, also considered to have agreed to disclosure.<sup>393</sup>

A practical approach, which has often been adopted in the UK to deal with this situation, is to ask tenderers to designate which specific information they regard as confidential and not for disclosure, whilst maintaining a principle of general openness and information sharing. This policy will need to be made clear in the contract documents. The extent of confidentiality may need to be discussed, however – for example, it would not be appropriate for a tenderer to designate as confidential information all material that it submits. The lack of clarity in the law will still create problems if no agreement can be reached in such cases.

Article 29(8) of the new Directive states expressly that ‘The contracting authorities may specify prices or payments to the participants in the dialogue’. This provision was included in the directive to recognise that the costs of participating in some award procedures for complex contracts can be very high, and that entities may thus wish to make some payment to participants to induce participation and improve competition. Entities may also wish to compensate providers whose proposals are incorporated into requirements presented to the other participants, as discussed above.

Nothing in the directives, in fact, prevents entities from making such payments in any award procedure, and they thus appear possible in all types of procedures, not just competitive dialogue. The fact that such an explicit provision is included for competitive dialogue does not appear to mean that payments are precluded in other award procedures; probably the provision merely clarifies the possibility in competitive dialogue, because it was a particular concern in the context of this procedure. Another possible interpretation of this provision is that, in the specific case of competitive dialogue (but not in other procedures), it prevents Member States from prohibiting such payments by their individual procuring entities.

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<sup>393</sup> S. Treumer, ‘Competitive Dialogue’ (2004) *Public Procurement Law Review* 178-186, at p.182.

## 5.2 Negotiated Procedure with a Notice

Authorities are permitted to use the negotiated procedures – both with a notice and without a notice - only in specific cases, which are laid down in the directives (as stated by Article 28 of the Public Sector Directive). The grounds and the conditions for the use of the negotiated procedure *with* a notice are laid down in Article 30 of the Public Sector Directive.

Whilst the negotiated procedure with a notice still requires the contract award to be made on the basis of objective criteria that are generally related to the contract, it does not provide the same guarantees as other procedures for monitoring objectivity – in particular, the submission of formal tenders to a set specification - and is confined, therefore, to exceptional cases.

It should first be noted that in cases concerning the negotiated procedure, without either a notice or competition, the ECJ has set out two important principles governing the grounds for use, namely that they should be interpreted strictly, and that the purchaser has the burden of proving the circumstances justifying their use.

The ECJ has not yet considered whether these principles apply to the negotiated procedure with a notice. The Court's statements are not expressly confined to procedures without a notice; however, the position of a negotiated procedure with a notice was not in issue in the cases, and it is a very different procedure from single source procurement, involving – as we will see - both publicity, competition, and a significant degree of transparency (for example, regarding use and disclosure the selection criteria and award criteria). It can be argued that the above principles should not apply as:

This form of the procedure is not truly a derogation from the directives' general principles, but merely a modified application of those principles, that takes account of the special features of some procurements.<sup>394</sup>

On the other hand, it should be acknowledged that the organisation of the provisions in the 2004 Public Sector Directive

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<sup>394</sup> S. Arrowsmith *The Law of Public and Utilities Procurement* (2<sup>nd</sup> ed., London: Sweet & Maxwell, 2005), chapter 8.

could support a different view. In this respect, Article 28 of the Directive sets out the general rule that entities must use open or restricted procedures; it then states that in ‘the specific circumstances expressly provided for in Article 29’, entities may use the competitive dialogue and, in the ‘specific cases and circumstances referred to expressly in Articles 30 and 31’, the negotiated procedure. The ECJ might deduce from the fact that competitive dialogue is treated separately, and the two negotiated procedures are treated together, that, whilst competitive dialogue may be a non-exceptional procedure, both negotiated procedures are exceptional.

A second general issue of interpretation to consider is whether there is any formal ‘hierarchy’ of procedures. It is conceivable that the ECJ might adopt a concept of hierarchy of procedures based on the transparency principle, which requires use of the most transparent procedure that is suitable for the case. If that is the case, the negotiated procedure with a notice could then be used only when other suitable procedures, including the competitive dialogue procedure introduced in 2004, are not available. Against this view, it can be argued that the Directive indicates quite clearly, in its explicit terms, the availability of the different procedures and, in certain cases, a choice between them when more than one is available – for example, it allows a free choice between open and restricted procedures. Where no choice is intended this is indicated specifically in the Directive (for example, the Directive specifically indicates that competitive dialogue is available only when a contract cannot be awarded by open or restricted procedure). However, there are some limited cases in which the availability of the negotiated procedure with a notice is affected by the existence and availability of other procedures, including the new competitive dialogue procedure, either under explicit rules in the Directive or by implication or analogy.

When entities choose the negotiated procedure, the record of the procedure must include the reasons why the procedure was selected (Article 43(f) of the Public Sector Directive). As in all cases in which the legality of procurement decisions is subject to review, maintaining a detailed audit trail that includes detailed reasons and evidence may be a significant help in preventing challenges being brought, and in defending them successfully.<sup>395</sup>

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<sup>395</sup> The value of such an audit trail is emphasised, for example, in the OGC’s guidance concerning use of negotiated procedures on PFI projects, *Competitive Dialogue Procedure: OGC Guidance on the Competitive Dialogue Procedure in*

An entity may always use a more stringent procedure than required. Thus, for example, a procuring entity may decide to make its final choice in a negotiated procedure with a notice based on final tenders *without* negotiations, even though the regulations permit some negotiations after any final tender phase.

The Directive first allows use of the negotiated procedure insofar as – in the words of the directives:

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 (Article30(1)(c)).

The difficulty in formulating specifications does not provide a reason to dispense with a competition altogether, but makes a formal and rigid procedure inappropriate.

A point of principle that is not addressed explicitly in the Directive, and that is related to the discussion above, is whether this ground for using the negotiated procedure with a notice is available when the contract could be awarded using the competitive dialogue procedure. We have already noted above the possibility that the ECJ might adopt a formal general hierarchy of procedures and if that were the case then reliance on this ground for using the negotiated procedure would depend on showing that the competitive dialogue procedure, also, is not suitable for the award of the contract. However, no such hierarchy exists currently. Nevertheless, even if there is no *general* hierarchy of procedures it might be argued that it is to be implied into the Directive – by analogy from the explicit provisions making the procedure subject to the use of the open and restricted procedures - that this ground for using the negotiated procedure is also subject to the non-availability of the more transparent competitive dialogue procedure. It might be argued that the failure to make use of the negotiated procedure explicitly subject to non-availability of competitive dialogue when competitive dialogue was introduced is a mere oversight (the issue simply was not considered), rather than indicating any positive intention to provide for a broad overlap

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*the new Procurement Regulations* (Jan 2006), <[www.ogc.gov.uk](http://www.ogc.gov.uk)>, accessed 30 November 2010, section 2.



between the negotiated procedure and competitive dialogue; and that the scheme of the provision in permitting negotiated procedures only as a ‘last resort’ when open and restricted procedures cannot be used also requires that it be considered subject to the non-availability of competitive dialogue. It seems likely that such an argument will find some sympathy with the courts. However, even if this is the case, it seems likely that the procedure will still be widely available in cases of the type of services –financial services and intellectual services - for which the Directive and regulations expressly envisage its use.

Even if the non-availability of competitive dialogue is not a formal condition for using this ground for the negotiated procedure, it seems likely that the introduction of competitive dialogue will lead the ECJ to give this ground for the negotiated procedure a rather narrower interpretation than it might otherwise have had, taking the view that the ground is only available in extreme cases of unsuitability of the open or restricted procedures, rather than whenever the open or restricted procedures are not commercially suitable.

A question of particular interest is how, in light of the legal principles outlined above, the procedure remains relevant to projects conducted under the UK’s Private Finance Initiative and other Public-Private Partnerships. The width of this ground (and others) for negotiated procedures became important in the United Kingdom in the context of privately financed infrastructure projects, under the PFI. The general practice, at least in the 1990s before a standardised approach had been developed to the main types of PFI contract, was to use the negotiated procedure with a notice; this was influenced by Treasury Taskforce advice that this procedure was generally available for PFI contracts. They were generally awarded through a process that involved commencing with a broad output specification that is gradually refined and completed, taking into account the results of a first stage of tendering and/or of discussions during the award phase, in a manner similar to that envisaged by the new competitive dialogue procedure. The application of the procedure to such cases has never been considered by the ECJ.

However, the question was addressed in the English courts – prior to the adoption of the 2004 Directive, when competitive dialogue was still not available - by Richards J. in *R. v Rhondda Cynon Taff County BC Ex p. Kathro*.<sup>396</sup> This case concerned a local authority PFI project

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<sup>396</sup> *R. v Rhondda Cynon Taff County BC Ex p. Kathro* [2001] EWHC Admin 527; [2002] Env LR 15, QBD

for a variety of facilities, including schools, community learning facilities, and arts and leisure facilities. Certain decisions, including the decision to use the negotiated procedure, were challenged by a community council and individual residents who opposed the PFI scheme. Richards J. concluded that the council was entitled to conclude that the circumstances justified use of the negotiated procedure. However, he did not set out his reasoning on this point. The *Kathro* case now needs to be considered in light of the new competitive dialogue procedure. This is particularly the case in view of the fact that it was because of doubts over the availability of the negotiated procedure for privately financed projects that competitive dialogue was conceived.

Since 2006, the Office of Government Commerce (OGC) guidance has suggested that the negotiated procedure is available for PFI only in 'very exceptional circumstances'. In practice, the number of negotiated procedures with a notice has declined significantly in the UK since Directive 2004/18 was implemented in 2006, and this decline corresponds closely with a rising use of the new competitive dialogue procedure. It seems likely that this reflects the guidance given by the OGC to the effect that competitive dialogue should generally be used for PFI projects and that the negotiated procedure is not normally available.

It is noteworthy, however, that speaking at the Partnerships UK annual conference in London in October 2009, the Treasury's Head of Partnerships, Charles Lloyd, indicated that there may be an imminent review of government policy in this area. The aim of the review would be 'to understand better when and how competitive dialogue is being used, how well it's working and how it compares to the negotiated procedure'. Mention was made in this context of the fact that 'one or two other countries are using the negotiated procedure as opposed to competitive dialogue' [for PFI-type projects].

It will be interesting to see whether the advice put out by the OGC regarding the availability and desirability of the negotiated procedure for PFI changes in any way in the near future, and leads to this procedure once again being widely used for PFI projects in the UK – or at least to greater use than at present.

It can finally be mentioned that the 'no specifications' ground does not apply to works and services contracts. The assumption that specifications can always be drawn up with precision for works and supply contracts can be criticised. However, the availability of the

competitive dialogue procedure to some extent ameliorates the problems that previously existed in these cases.

Under the Public Sector Directive, a contract may also be awarded by the negotiated procedure with a notice where the nature of the goods, work(s) or services, or the risks attaching to performance, are such 'as not to permit prior overall pricing' (Article 30(1)(b)).

## **6. Conclusion**

The EU Treaty does not restrict Member States' freedom to grant contractual PPPs or establish IPPPs. The focus is on ensuring that the methods used to do so are compatible with Community law. The relevant Community rules include those on competition, state aid, as well as public procurement. This chapter has examined the treatment of different types of PPPs, namely concessions, other contractual PPPs (typically PFI) and IPPPs under the EU procurement rules, which consist of EU Treaty free movement rules, principles developed in the case law and the backbone of EU procurement regime, the Public Procurement Directives.

It is clear from the above discussion that the procurement rules, both those on coverage and those on procurement procedure, applicable to PPPs, need to be further clarified. The Commission has taken a number of initiatives to provide guidance through adoption of non-binding soft-law measures. Given the diversity of Member States' practice on PPPs, it is not easy for the Commission to enhance legal certainty in such a dynamic and economically significant area. The case for a binding legislative instrument and its scope remain unclear, although the Commission has declared its intention for 6 years.

It is arguable that the Commission should focus its limited resources on striking the right balance between legal certainty and Member States' discretion; between transparency and commercial flexibility; and between public and private partners in a PPP co-operation. Urgent work should also be done to clarify the relationship between the main procurement procedures for PPPs, namely competitive dialogue and the negotiated procedure with a notice.

It can be argued that the current EU procurement legal framework on PPPs remains focused on non-discrimination, equal treatment and transparency, and, to a large extent, neglects the need for public and private partners to engage in commercial viable co-operations based on trust. This is highlighted by the Commission's 'trust-breaking' recommendation in its recent Interpretative Communication on IPPPs,

that the statutes and articles of association of a PPP ‘should be so formulated that it is possible to change the private partner in the future’.<sup>397</sup>

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<sup>397</sup> Commission (EC), ‘Interpretative Communication on the Application of Community Law on Public Procurement and Concessions to Institutionalised Public-Private Partnerships (PPP)’ (Communication) C (2007) 6661, 5<sup>th</sup> February 2008, at 2.2

## Chapter 5

### PPP in China

#### 1. Introduction

The development of the private sector in China has been gaining momentum following a series of centrally-issued, encouraging political and policy initiatives in the past few years.<sup>398</sup> The private sector is allowed to engage in service provision in almost all sectors traditionally monopolised by government or state owned enterprises (SOEs).

Along with this development comes the third wave of Chinese public procurement reform and regulation - the emerging regulatory framework governing the procurement of privately financed infrastructure project (PFIP), and the distinctive legislative development of concession regulation in urban infrastructure and utilities sectors.

This chapter will present a review of these policy and legal developments in order to explore the emerging legal framework for

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<sup>398</sup> For example, National Planning Commission, Notice on Publishing the Opinions on Promoting and Guiding Private Investment, issued on December 11, 2001; National Planning Commission, Some Opinions On Some Policy Measure To Increase The Development Of Service Sectors In The 15th Five Year Period, issued in January 2002; Ministry of Construction, Opinion On Promoting The Marketization Of Urban Public Utilities, issued on December 27, 2003; Ministry of Construction, Measures On Urban Public Utilities Concession, issued in 2004; State Council, State Council Decision Regarding The Investment System Reform, issued in July 2004; State Council, Opinions On Encouraging, Supporting And Guiding The Development Of Non-State Sector Economies, issued in 2005.

the new public private partnerships and the main regulatory issues concerned.

Part 2 will present a brief review of the development of policy and regulation to encourage private provision of public service in China. Part 3 will present some insights on what the current regulations could contribute to the future legislative framework and the new regulatory issues to be addressed. Part 4 concludes this chapter.

The purpose of this chapter is to review whether appropriate regulatory objectives have been established by the new Regulations, and to what degree the substance of the new Regulations have helped to achieve these objectives. This chapter also seeks to explore what issues remain and need to be addressed by future regulation to create a more favourable legal framework for private finance in infrastructure in China.

## **2. Recent legislative initiatives**

Despite its ups and downs, the Chinese private sector has managed a steady and sustainable development after the initiation of the Chinese economic reform. It could be observed that the time for political and ideological restriction of private sector development has passed, and constitutional and legal barriers have been removed.<sup>399</sup> The private sector enjoys full autonomy in its development in competitive and commercial sectors.

However, private development in the public service sector is not as smooth. This is possibly due to the fact that public service traditionally falls under the monopoly of the government and SOEs.

Even when this domain is opened up to private sector, it is foreign investors that are preferred, for various policy and practical reasons.

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<sup>399</sup> During a considerable period of time before 1978, the non-state sector economy was severely restricted or even prohibited. However, the constitutional position of the non-state sector economy has gradually changed through several amendments to the Chinese Constitution Law, especially noteworthy is the 1999 Amendment to the Chinese Constitution Law, which establishes the non-state sector economy as an important component of the socialist market economy and supports its equal legal status with the state sector economy. The 2004 Amendment to the Chinese Constitution Law further establishes that ‘the State protects the legitimate rights and interests of the individual, private and other non state sector economy. The State encourages, supports, and guides the development of the non state sector economy and supervises and manages the non state sector economy, according to the law.’

For example, local governments may be keen to engage foreign investment to raise the local government's profile, particularly when the indicators of success for local government are based on GDP development and the amount of foreign investment employed; or the management of SOEs may like to use its foreign partner as leverage to resist governmental control and maintain some degree of autonomy. Amongst the few privately financed infrastructure and utilities projects, most are regulated on a case-by-case basis through contracts. There is no sectoral or general legislation governing the awarding of contracts and supervision of the project's operation, except for in a few cases, where a specific local regulation is enacted governing the operation of one particular privately financed infrastructure project (PFIP).

This situation has been changing dramatically, with recent policy and legal developments encouraging private engagement in public service provision. A number of policies at ministerial and State Council level have been issued in the past few years, declaring a policy of liberalisation in the sectors traditionally monopolised by the state or SOEs. Especially noteworthy are the State Council Opinions on Encouraging, Supporting and Guiding the Development of the Non-State Sector Economy.<sup>400</sup>

The Opinions have liberalised wide sectors of the economy, including the traditionally monopolised sectors such as telecommunication, civil aviation, oil, and rail transportation, etc., urban infrastructure and utilities, social sectors and, to some degree, the military sector. They also provide for the various ways that private investment can be employed, including shareholding, joint ventures and project finance.

The Opinions have had profound policy and practical implications for private engagement in public service provision in China. Domestic private investors are now accorded equal rights with foreign investors, and some implementing government measures, and Regulations of a general nature, have been initiated. Amongst these is the distinctive legal development of the Concession Regulations, which govern the formation and operation of a new type of public private partnerships relationship. Within three years, one ministerial provision was

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<sup>400</sup> State Council, The Opinions on Encouraging, Supporting and Guiding the Development of Non-State Sector Economies, issued in 2005.

promulgated and four provincial provisions later followed, governing urban utilities concessions.<sup>401</sup>

The Beijing Municipal Government is also following this approach, but is taking a different path; its Regulations refer not to *utilities*, but rather to *infrastructure* concessions.<sup>402</sup> However, the coverage of the Regulations is somewhat the same and it is arguable that the term of utilities and infrastructure in these Regulations could be used interchangeably.<sup>403</sup>

This chapter will examine the three Congress-made Regulations, namely the Beijing Regulation, Shenzhen Regulation and Xinjiang Regulation; the Ministerial Provision is also referred to where relevant.

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<sup>401</sup> Ministry of Construction, Provisions on Urban Public Utilities Concession, issued in 2003 (hereafter referred to as the Ministerial Provisions); Shenzhen Municipal Government, Shenzhen Municipal Provision on Urban Public Utilities Concession, issued in 2004, later upgraded to a Congress-made law; People's Congress of Shenzhen Municipality, Shenzhen Municipal Regulation on Urban Public Utilities Concession (hereafter referred to as the Shenzhen Regulation), enacted in December 2005, effective on March 1, 2006; People's Congress of Xinjiang Autonomous Region, Regulation on Public Utilities Concession of Xinjiang Autonomous Region (hereafter referred to as the Xinjiang Regulation), issued in 2005; another two provincial provisions are found in Guizhou province and Tianjin municipality (hereinafter referred to as Guizhou Provision and Tianjin Provision).

<sup>402</sup> Municipal Government, The Urban Infrastructure Concession Provision of Beijing Municipality, issued in 2004, and later upgraded to People's Congress of Beijing Municipality, The Urban Infrastructure Concession Regulation of Beijing Municipality (hereafter referred to as the Beijing Regulation), passed on December 1, 2005, effective on March 1, 2006. A review of the Beijing Regulation can be found in C. Fuguo, 'The Emerging Legal Framework in Private Finance in Infrastructure in China: a Review of the Beijing Concession Regulation' (2006) 15 *Public Procurement Law Review* 62.

<sup>403</sup> The term of infrastructure and utilities are also used interchangeably in other context. For example, Gómez-Ibáñez uses the terms 'infrastructure industries' and 'public utilities' interchangeably. See J. A. Gómez-Ibáñez, *Regulating Infrastructure: Monopoly, Contracts, and Discretion* (Cambridge, Mass.: Harvard University Press, 2003).



### **3. The legal framework and main regulatory issues for PFI project: a review of current regulations in China**

#### **3.1 Regulatory objectives**

Various policy objectives can be found in the regulation of infrastructure and utilities, including: the protection of social interests, and the interests of the market operator and consumers; the improvement of the level of public service, enhancing the process of infrastructure marketisation and promoting competition; increasing the efficiency of allocation of public resources; enhancing the transparency of the regulatory process; and encouraging public participation in regulation.<sup>404</sup> Some of these are related to overall infrastructure/utilities regulation, while others are specific to the PFIP regulation. For example, an Act of UK legislation on utilities requires the protection of the utility consumers' interests as the primary objective of the regulator;<sup>405</sup> all other policy concerns, such as effective competition and efficient allocation of resources, quality of service, etc. only serve as policy tools towards the higher policy objective of consumer protection. This presumably applies to all utilities operators, whatever the means of utilities provision.

However, PFIP regulation may have a more immediate regulatory objective, as is discussed in the UNCITRAL Guide on PFIP Legislation.<sup>406</sup> The UNCITRAL Guide has explicitly declared that 'the purpose of the Guide is to assist in the establishment of a legal framework favourable to private investment in public

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<sup>404</sup> The objectives of infrastructure Regulations are discussed in a study report 'A Study on the Legislative Framework and Regulatory Issues in Regulating Beijing Municipal Infrastructure', commissioned by the Beijing Municipal Government, and conducted by the author and colleagues in 2004.

<sup>405</sup> Utilities Act 2000, ss.9 and 13, laying out the principal objective and general duties of the Secretary of State and the Authority, provides that 'the principal objective of the Secretary of State and the Gas and Electricity Markets Authority in carrying out their respective functions under this Part is to protect the interests of consumers in relation to gas conveyed through pipes, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas so conveyed'.

<sup>406</sup> UNCITRAL, UNCITRAL Legislative Guide on PFIP, (Fifty-fourth session, Supplement No. 17, New York: United Nations, 2001), (hereafter referred to as the UNCITRAL Guide).

infrastructure’,<sup>407</sup> and that ‘the constitutional, legislative and institutional framework should ensure transparency, fairness, and the long-term sustainability of projects’.<sup>408</sup>

Three issues are raised with respect to the establishment of appropriate regulatory objectives in the new Chinese Regulations.

### **3.1.1. Employment of private capital vs. market reform in infrastructure sectors**

Some of the Chinese Regulations make it clear that the purpose of the PFIP legislation is to ‘expand the means of financing’ of public infrastructure. This is particularly the case with regards to the Beijing Regulation, where an advocate for the Regulation states that one of the primary objectives of the Regulation is ‘to expand the channel of finance in urban infrastructure and to attract domestic and international investment’.<sup>409</sup> This is understandable when one considers the investment pressure imposed by the ever-increasing infrastructure demand generated by both the 2008 Olympic Games and the metropolitan population. However, it would be a mistake simply to employ private capital and award monopoly rights to private enterprise.<sup>410</sup>

A key aim in awarding concession rights is to encourage market reform and competition. It could be argued that, only when fair market rules are established, can private finance be genuinely motivated. Therefore, even in legislation governing the narrow issue of concessions, the objective of wider market reform and competition should be established. The issues of competition or monopoly, public or private monopoly, actually fall within the government policy options in the context of private finance in infrastructure,<sup>411</sup> as is discussed in the UNCITRAL Guide:

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<sup>407</sup> UNCITRAL Guide, Introduction, at para.4.

<sup>408</sup> Consolidated Legislative Recommendation, included in the UNCITRAL Guide.

<sup>409</sup> D. Xiangyang, ‘‘Explanations on the Beijing Regulation’’ (draft), presented to the Beijing Municipal Congress accompanied with the Draft; this objective is provided in Art. 1 of the former Government provisions and Art. 2 of the Beijing Regulation succeeds.

<sup>410</sup> J. Stieglitz, ‘‘Enhancement of Regulation and Competition Policy: the Case of Network Industry’’, in *The Theory and Policy of Chinese Regulation and Policy* (Z. Xinzhu ed., Social Science Documentary Press, 2000) p.364. (In Chinese).

<sup>411</sup> Actually one of the World Bank Policy Papers has recommended that government should consider the introduction of competition through reform of

Essential elements of national policies include the level of competition sought for each infrastructure sector, the way in which the sector is structured and the mechanisms used to ensure adequate functioning of infrastructure markets. National Policies to promote private investment in infrastructure are often accompanied by measures destined to introduce competition between public service providers or to prevent abuse of monopolistic conditions where competition is not feasible.<sup>412</sup>

The Guide also provides a detailed discussion of the competition policy in relation to private finance in infrastructure, policies concerning the reformation of the infrastructure sector, and relevant experience.<sup>413</sup> While recognising the fact that some countries may feel it necessary to provide for temporary exclusivity rights, limitation in the number of public service providers, or other restrictions on competition to encourage private investment, the Guide also recommends that these should only be temporary or transitional measures and ‘the transition from monopoly to market needs to be carefully managed’.<sup>414</sup> It can be argued that the UNCITRAL Guide has clearly embraced the policy of competition and market reform in infrastructure with private finance.

Bringing the discussion back to the Chinese context, the endorsement of a wider objective of market reform in the new PFIP Regulation does not seem to be easy to achieve in practice. For example, during the legislative process for the Beijing Regulation, the leading driving force behind this Regulation, the Beijing Municipal Development and Reform Commission (BMDRC), was very keen to promote marketisation and reform of the whole infrastructure sector and to establish a fair market order through wider coverage for the new Regulation. A wide consensus was also reached among working group members to establish as a primary regulatory objective the promotion of infrastructure marketisation. However, the issue turned

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market structure before the award of concession contract. See K. Michel, R. David Gray, T. Irwin, C. Levesque, and R. R. Taylor, *Concession For Infrastructure: a Guide to their Design and Award*, World Bank Technical Paper No.399, at p.7.

<sup>412</sup> UNCITRAL Guide, Introduction, at para.21.

<sup>413</sup> *ibid.*

<sup>414</sup> UNCITRAL Guide, Introduction, at para.44.

out to be subtle and complicated, and enacting such a provision would perhaps have substantially delayed the legislative process; an explicit declaration of such a marketisation policy in the objective chapter was, unfortunately, dropped.<sup>415</sup>

However, the policy objective of marketisation is found in other Regulations. For example, the Ministerial Provision by the Ministry of Construction declares as one of the regulatory objectives the promotion of market reform and the establishment of an open and competitive municipal utilities market; the Tianjin Provision governing public utilities concessions also follows this approach.

### **3.1.2 Balancing of public and private interests: the principle of the precedence of the public interest**

Another objective of PFIP Regulation is to achieve a balance between private and public interests.

As is discussed in the UNCITRAL Guide:

a fair legal framework takes into account the various (and sometimes possibly conflicting) interests of the Government, the public service providers and their customers and seeks to achieve an equitable balance between them.<sup>416</sup>

Thus:

the advice provided in the Guide aims at achieving a balance between the desire to facilitate and encourage private participation in infrastructure projects, on the one hand, and various public interest concerns of the host country, on the other.<sup>417</sup>

All current Chinese Regulations declare a similar balance of interests objective. For example, the Beijing Regulation aims at protecting social and public interests; ensuring quality provision of public goods and services; and protecting the legitimate rights of concessionaire. In

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<sup>415</sup> See People's Congress of Beijing Municipality, Report on the Review Opinions of the Draft Beijing Regulation, by the Finance and Economic Commission.

<sup>416</sup> UNCITRAL Guide, Chapter 1, at para.5.

<sup>417</sup> UNCITRAL Guide, Introduction, at para.4.

practice, however, the structure of the various interests is an issue of negotiation; thus, the achievement of the balance of interests objectives depends very much upon the selection and negotiation process, and the resulting contract between the contracting parties.

The legislature has been greatly concerned that the government may, on some occasions, be vulnerable to exploitation by the private operator seeking excessive profits. This is particularly true where there is no accountable political system in place: the Regulations are poor; the project implementation process can be easily manipulated; and a sound supervisory system is yet to be established. These situations are very likely to exist in the Chinese context. Therefore, while accepting the importance of private interest protection, regulators are also keen to safeguard public interests. All Regulations establish the ‘principle of public interest precedence’, which means that when conflicting interests arise, public interests should be assigned a priority for protection.<sup>418</sup>

While the issues of public interest protection are mostly associated with the obligations of the concessionaires,<sup>419</sup> they also concern the duties on public authorities as created by the new Regulations. For example, in order to protect the public interest, the Xinjiang Regulation imposes a duty on the Municipal Government not to sell public property to the private sector. This is intended to curb the allegedly expanding practice at local level of selling public service facilities cheaply to the private sector as a means of relieving the government of a financial burden. Some Regulations also require the supervisory authority to keep an emergency plan in place to ensure the continuous supply of public services in the case of irregularities.

There are also measures throughout the Regulation that are designed to protect the interest of investors, including: transparency of laws and Regulations in the award process, and predictability and impartiality in their application;<sup>420</sup> in respect of concession contracts by the Government,<sup>421</sup> on strengthening the co-ordination between government bodies;<sup>422</sup> on government support and commitment;<sup>423</sup> on

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<sup>418</sup> Beijing Regulation, Art. 5.

<sup>419</sup> See the discussion below in section 3.6.1.

<sup>420</sup> e.g. Art. 11 of the Beijing Regulation.

<sup>421</sup> e.g. *ibid.*, Art. 19.

<sup>422</sup> e.g. *ibid.*, Arts 6 and 18.

<sup>423</sup> e.g. *ibid.*, Arts 15, 16 and 17.

the protection of commercial secrets;<sup>424</sup> and, on compensation payable in the case of policy change.<sup>425</sup>

The Beijing Regulation also restates the right for the aggrieved concessionaire to resort to formal proceedings<sup>426</sup> provided by other laws. However, no separate challenge and dispute resolution system is provided for by the Regulation itself.

### **3.1.3 Consumer interest protection as a primary objective?**

The ultimate objective of infrastructure/utilities regulation is to increase consumer welfare. In addition, consumers can play an important role in supervising the operation of public services.

Recognising the government's primary objective of consumer protection and the consumer input mechanisms that exist in other jurisdictions, advocates of the new Regulations propose similar provisions and mechanisms for the new Concession Regulations. However, the issue is so closely related to the development of a consumer society that it is no surprise that the effort to declare consumer protection as a primary regulatory objective failed in the case of the Beijing Regulation.

However, some welcome advances have been achieved — some Regulations require the establishment of a utilities committee, a new consumer mechanism similar to its British counterpart.<sup>427</sup>

## **3.2 The concept of a concession**

The concession is a basic concept that is the focus of the Regulations, and which affects the legal arrangement of the fundamental rights and obligations between the parties concerned. All of the Regulations discussed in this chapter provide an explicit chapter dealing with the definition of a concession.<sup>428</sup> A typical example defines a concession as 'a contractual arrangement' under which enterprises and other

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<sup>424</sup> e.g. *ibid.*, Art. 29.

<sup>425</sup> e.g. *ibid.*, Arts 30 and 32.

<sup>426</sup> e.g. *ibid.*, Art. 33.

<sup>427</sup> In the United Kingdom, several consumer voice mechanisms are established in relevant Utilities Regulations; for example, the Voice of Water in the water industry.

<sup>428</sup> The Beijing Regulation, Art. 2; Shenzhen Regulation, Art. 3; and the Xinjiang Regulation, Art. 2.

economic organisations are granted the right, through fair competition offered by the Government, to operate defined urban infrastructure and provide public goods or services, within a certain period of time and in a certain geographical area.<sup>429</sup> However, this definition does not itself indicate the way in which such an operation is remunerated as well as other fundamental features of concessions that can be found in definitions from other jurisdictions.

One distinctive feature of a concession more generally is that revenue is generated from user fees, not from general public finance. For example, in France, the common feature of the legal arrangement termed a concession is that the revenue of the concessionaire must be linked with the collection of user fees.<sup>430</sup> Such a user-pay feature can also be found in the United Kingdom context, where one Act of Parliament defines a concession agreement as an agreement entered into by a highway authority under which a person (the concessionaire), in return for undertaking such obligations as may be specified in the agreement with respect to the design, construction, maintenance, operation, or improvement of a special road, is appointed to enjoy the right (conferred or to be conferred by a toll order) to charge tolls in respect of the use of the road.<sup>431</sup> The EU Directive defines a concession as a contract under which:

the consideration for the works to be carried out consists either solely in the right to exploit the construction or in this right together with payment.<sup>432</sup>

Other documents further clarify that:

exploitation means that the provider carrying out the work, instead of being paid directly by the awarding authority initiating the procedure, earns revenue from the

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<sup>429</sup> Beijing Regulation, Art. 2.

<sup>430</sup> See P. Boeuf, 'Public-private Partnerships for Transport Infrastructure Projects Annex 1', paper delivered at 'Transport Infrastructure Development for a Wider Europe', Paris, November 27–28, 2003.

<sup>431</sup> New Roads and Street Works Act 1991 (UK), s 1(1).

<sup>432</sup> Council Directive (EC) 2004/18 on the co-ordination of procedures for the award of public works contracts, public supply contracts and public service contracts [2004] OJ L134/114 Art. 1.

fees charged to users of the construction when it is complete.<sup>433</sup>

Therefore, there is a widely shared understanding that the fundamental feature of a concession is the financing mechanism of user-pay, which distinguishes itself from the other private finance arrangements of public service provision, such as, for example, some types of PFI arrangement in the UK context, such as prisons and hospitals, which are not financed on a user-pay basis.<sup>434</sup>

Referring back to the Chinese context, the definition in the Chinese Regulations does not help much in clarifying the meaning and legal arrangement of a concession. However, it could be observed from other places in the Regulation that remuneration in a concession project may include: user payments; a right to develop and operate facilities related to the particular urban infrastructure; government subsidies; and other means of remuneration agreed by the government.<sup>435</sup> Article 17 of the Beijing Regulation, which mainly concerns government support and guarantees, further provides that such remuneration may also be in the form of government procurement of the products and service provided by the concessionaire.<sup>436</sup> However, the government shall not, in any case, undertake to guarantee a fixed rate of return on the investment, or commit itself to commercial risk.<sup>437</sup> The feature of user-pay in a concession arrangement could further be implied by the form of the concession arrangements of BOT (built-operate-transfer) and TOT (transfer-operate-transfer) when the Government is designing a concession project.

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<sup>433</sup> Commission (EC), 'Draft Commission interpretative communication on concessions under Community law on public contracts' (Communication) O.J. C94/4, 7 April 1999.

<sup>434</sup> See S. Arrowsmith and P. Badcoe (eds.), *Public Private Partnerships and PFI* (London: Sweet & Maxwell, 1999); S. Cirell, J. Bennett and R. Hann, *Private Finance Initiative and Local Government* (London: Sweet & Maxwell, 1997); G. Lindrup and E. Godfrey (eds.), *Butterworth's PFI Manual: Law, Practice and Procedure Relating to the Private Finance Initiative and Public/Private Partnerships* (London: Butterworths, 1998); N. Morrison and N. Owen, *Private Finance Initiative: A Specially Commissioned Report* (London: FT Law & Tax, 1996); J. Fox and N. Tott, *The PFI Handbook* (Bristol: Jordans, 1999).

<sup>435</sup> e.g. Beijing Regulation, Art. 15; and Shenzhen Regulation, Art. 22.

<sup>436</sup> Beijing Regulation, Art. 17.

<sup>437</sup> e.g. *ibid.*



Furthermore, the Chinese definition does not address the role that project risk can play in determining whether the procurement arrangement is a concession. The European Commission has made it clear that:

[E]ven though the origin of the resources - directly paid by the user of the construction - is, in most cases, a significant factor, it is the existence of exploitation risk, involved in the investment made or the capital invested, which is the determining factor, particularly when the awarding authority has paid a sum of money.’’<sup>438</sup>

Therefore in EU law, whether the project risk is transferred to the concessionaire is a crucially important factor in determining the nature of the contract and application of government procurement law. For example, based on this risk criteria, if the government undertakes to guarantee the project payment, or is committed to a fixed return on the investment, it is not a concession contract. It is also argued that a concession does not cover the situation where payments are made to the provider from the authority’s funds *based on* public u - for example, where the authority pays a road operator based on the number of road users (shadow tolls).<sup>439</sup>

Similar risk issues may also arise in the Chinese context, given that government support to the project may include government payment in the form of subsidies, development rights for related facilities, etc. However, the Regulations provide little guidance in this respect, except for imposing a duty on the authority not to guarantee any fixed rate of return on the investment nor to be committed to any commercial risk, which itself is by no means clear. Therefore, the role

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<sup>438</sup> See the Commission (EC), ‘Interpretive Communication of the Commission on Concessions under Community law’ (Communication) OJ C 121/2, 29 April 2000, at p.8. Similar indications can be found in other official documents: it should be noted that it is the criterion of the right of exploitation, and its corollary, the transfer of the risks inherent in the exploitation, which distinguish public contracts from concessions. Commission (EC), ‘Green Paper On Public-Private Partnerships And Community Law On Public Contracts And Concessions’ (Green Paper) COM (2004) 327 final, 30th April 2004, at p.36.

<sup>439</sup> S. Arrowsmith, ‘Public Private Partnerships and the European Procurement Rules: EU Policies in Conflict?’ (2000) 37 *Common Market Law Review* 709.

of the project risk in determining a concession project remains to be seen.

### **3.3 The application of the Regulations**

The Regulations only cover situations where the infrastructure or utilities service are provided in the form of a concession.<sup>440</sup> Therefore, it is important to decide what constitutes the definition of a concession for the purpose of the Regulation's application; as discussed above, this is not quite clear.

However, this does not appear to be problematic in the application of the Regulation since the Government generally agrees on a concession arrangement at an earlier stage in the project proposal (possibly based on private finance and user pay test), and when it decides to proceed with the project in the form of concession, the Regulation will then automatically apply.

The Regulations leave open several crucial policy issues with regard to the definition of concession and the regulation. First, a concession is only one of the policy tools that the Government may employ to provide a public service. At least in theory, the Government may still choose to provide the public service itself, or through a state owned enterprise; or it may choose to provide the service through government procurement, or other forms of private finance (PFI in United Kingdom, for example). Secondly, the decision to provide an infrastructure service through a concession arrangement is an important issue of public policy. It is submitted that the Regulation should provide some guidance to aid such a public choice. A good example is the Beijing Regulation, which places an emphasis on the procedures governing the proposal and determination of a concession project. The Xinjiang Regulation also provides for some principles governing the determination of a concession project.<sup>441</sup> Thirdly, it is good practice for the Government to specify the criteria and standards that will be employed to evaluate the merits of using the concession approach and to decide whether to use it. However, the current Regulations simply say nothing on this.

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<sup>440</sup> Beijing Regulation, Art. 3; Xinjiang Regulation, Art. 2; and Shenzhen Regulation, Art. 3.

<sup>441</sup> Xinjiang Regulation, Art. 4.

The Regulations also set out the specific sectors where concessions may be employed as a means to provide infrastructure services. These sectors include supply of water, gas and heating; treatment of sewage and solid refuse; and public transport. This could be extended to include additional sectors under the possible scope of coverage of the Regulations, either through a decision of the Municipal Government in the case of Beijing, or through provisions in laws and Regulations.<sup>442</sup> It could be observed that despite the difference in terminology between an urban infrastructure concession and an urban utilities concession, the sectors covered by the law are largely the same.

### **3.4 Allocation of government functions and their co-ordination**

The successful delivery of the concession project is very dependent on the effective support from, and co-ordination amongst, different parts of government. This is important because the concession project may involve several government functions; alongside the concession project some new government functions may also arise, such as the contracting and regulatory functions. Current Regulations have shown considerable concern over this issue. For example, the Shenzhen Regulation places the delegating power<sup>443</sup> and contracting authority<sup>444</sup> with the Municipal Government itself, and the supervisory power with the competent authority in charge of the utilities sector, although, as a measure to co-ordinate the relevant supervisory functions among government departments, it further provides that other relevant departments are to assist with the performance of the supervisory functions within their respective authority.<sup>445</sup> The Xinjiang Regulation is different from the Shenzhen Regulation in that it places both the contracting and supervisory functions with the authority in charge of the utilities sector.<sup>446</sup>

The issue of allocation of government functions and their co-ordination is also of legislative concern in the Beijing Regulation, a concern which is reflected in several Articles. One Article establishes

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<sup>442</sup> Beijing Regulation, Art. 3; Xinjiang Regulation, Art. 2; and Shenzhen Regulation, Art. 3.

<sup>443</sup> Shenzhen Regulation, Art. 7.

<sup>444</sup> Shenzhen Regulation, Art. 15.

<sup>445</sup> *ibid.*, Art. 6.

<sup>446</sup> Xinjiang Regulation, Art. 7.

the competent sectoral departments<sup>447</sup> as being both the contracting and supervisory authorities.<sup>448</sup> However, the Beijing Regulation is under a different banner from the Shenzhen and Xinjiang Regulations, and it allocates a much larger role to the Beijing Municipal Development and Reform Commission (BMDRC) - while embracing its traditional leading roles in infrastructure related functions, it adds more roles on co-ordination and supervision of concession projects.<sup>449</sup>

In addition, the Beijing Regulation provides for a specific measure to co-ordinate government functions for concession projects. It requires relevant competent authorities to provide early reviews on the project implementation plan (PIP) for the project and present official comments.<sup>450</sup> These relevant authorities are not supposed to conduct a second review on the same issue once the concession agreement is concluded and the concessionaire is finalising proceedings with the relevant authorities. The Regulation further requires that the review of other issues at this stage may not cause any substantive change to the concession agreement.<sup>451</sup> This is a measure specially designed both to co-ordinate the different internal functions of government, and to honour the commitment by the government, which may help to encourage a well-prepared PIP for the concession project and accelerate the project implementation process.

Another important element of concession projects is related to price regulation. Since this is an issue dealt with in the primary Chinese Price Law, recent Regulations maintain the status quo with regards to the authority over price regulation. However, it is worthwhile observing how the newly established supervisory authority will co-ordinate with the old price regulatory body located in other parts of government, particularly the Development and Reform Commission.

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<sup>447</sup> e.g. the Municipal Transportation Commission is in charge of the transport industry. Similar sectoral authorities in Beijing are the Municipal Water Authority, the Municipal Administration Commission, etc.

<sup>448</sup> Beijing Regulation, Art. 6.

<sup>449</sup> See C. Fuguo, 'The Emerging Legal Framework in Private Finance in Infrastructure in China: a Review of the Beijing Concession Regulation' (2006) 15 *Public Procurement Law Review* 62.

<sup>450</sup> Beijing Regulation, Art. 10.

<sup>451</sup> *ibid.*, Art. 18.

## **3.5 The selection procedure**

### **3.5.1 The pre-selection stage and preparation**

#### **3.5.1.1 Determination of a concession project**

The initial decision about whether to provide the infrastructure or service by means of a concession project involves an important area of public policy. Considerations as to whether a concession should be used include whether the project should be provided through public finance or private finance, and, if the latter, what forms of private finance, whether through SOEs or private enterprise. The decision whether to proceed by way of a concession project in the first place may involve a review of all of the alternative policy options, possibly supported by a cost-benefit analysis, as well as a study of the feasibility of the project, which is traditionally required when a government project is proposed to the authority for approval. Further, the decision to undertake a concession project may be more than an economic and technical issue; rather, it may be a political and social one, and, therefore, may involve issues of public participation and transparency requirements, which are important elements for the sustainability of the project.

As far as the current Regulations are concerned, the Shenzhen Regulation simply says nothing on this important issue. The Xinjiang Regulation provides for a general principle, requiring the decision on a concession project be based on ‘reasonable site selection and effective allocation of public resources’,<sup>452</sup> and further requires a public hearing or other forms of public participation to be managed before a decision is made.<sup>453</sup>

The Beijing Regulation provides for detailed procedures guiding the proposal and the determination of a concession project. While the BMDRC and the sectoral authorities can propose a concession project,<sup>454</sup> a decision on whether or not to use the concession approach is generally made by the BMDRC, with a few key projects subject to the Municipal Government’s further approval.<sup>455</sup> The Regulation also

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<sup>452</sup> Art. 4.

<sup>453</sup> Art. 10.

<sup>454</sup> Beijing Regulation, Art. 7.

<sup>455</sup> *ibid.*, Art. 8.

provides for a general principle requiring the decision of a concession project to be in line with the city's planning and development requirements. It should be noted that regulators envisaged that all project proposals are initiated by government alone, and that a move to address the issue of unsolicited offers in the Regulation was not accepted.<sup>456</sup> A procedure to involve the public voice and public participation in the project decision was also omitted.

### 3.5.1.2 Project implementation plan

After a concession project is determined, the contracting authority shall prepare a project implementation plan (PIP),<sup>457</sup> which lays out the basis for the award process<sup>458</sup> and provides for the substance of the concession agreement.<sup>459</sup> This is the most important preparatory work before the formal award procedure is initiated. Some of the Regulations provide particular Articles for dealing with the content of the PIP, and its review and approval. For example, both the Beijing and Shenzhen Regulations contain Articles specifying the required content for PIP.<sup>460</sup> The Beijing Regulation also contains an Article specifying the power of relevant authorities and the procedure for the review and approval of the PIP. Both the Beijing and Xinjiang Regulations require approval from the Municipal Governments.<sup>461</sup> The Shenzhen Regulation further requires a public hearing to be held concerning the relevant issues contained in the PIP;<sup>462</sup> and the Xinjiang Regulation requires the public voice to be heard through public hearings or some other open procedure before the PIP is

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<sup>456</sup> For a discussion on the appropriate policy for unsolicited offers, see UNCITRAL Guide, Ch.3, at paras 97–117. The issue of transparency in dealing with an unsolicited offer is an important aspect of the evaluation on concession regulations in East European countries. See European Bank For Reconstruction and Development Office of the General Counsel, *Report on the Quality of Concession Legislation in Early Transition Countries*, June 2005, at: [www.ebrd.com/country/sector/law/index.htm](http://www.ebrd.com/country/sector/law/index.htm) accessed 30 November 2010.

<sup>457</sup> Art 9 of Beijing Regulation; Art. 9, Shenzhen Regulation; Art. 14, Xinjiang Regulation, Art. 9.

<sup>458</sup> e.g. Art. 9 of the Beijing Regulation; a similar requirement is found in Art. 14 of the Shenzhen Regulation.

<sup>459</sup> e.g. Art. 13 of Beijing Regulation.

<sup>460</sup> Beijing Regulation, Art. 9; and Shenzhen Regulation, Art. 14.

<sup>461</sup> Beijing Regulation, Art. 10; and Xinjiang Regulation, Art. 9.

<sup>462</sup> Shenzhen Regulation, Art. 14.

approved.<sup>463</sup> The draft Beijing Regulation initially provided for a similar Article requiring public consultation when the BMDRC deems necessary. Though this Article was, unfortunately, removed, a requirement for objective verification of the key PIPs by professional experts is instead included.<sup>464</sup> However, the Beijing Regulation does not further provide for the timescale and phasing of such a review and verification—it could be at an early phase before the contracting authority submits the PIP to the BMDRC for internal review; at a later stage before the BMDRC submits the PIP to the Municipal Government for approval; or at both phases.

### **3.5.1.3 Types of concession and the scope of the concession right**

Both the Beijing and Shenzhen Regulations allow for concession arrangements similar to BOT, TOT,<sup>465</sup> or an arrangement of delegation to a concessionaire of certain public service provisions.<sup>466</sup>

Under the Xinjiang Regulation concession, rights may exist in the form of a complete right to invest, construct and operate a facility, or alternatively a single right of operation.<sup>467</sup> This indicates that the form of the concession arrangement under the Xinjiang Regulation is similar to those under the Beijing and Shenzhen Regulations. It is worth noting that other forms of concession arrangement may be employed, provided they are further authorised by government provision (Beijing Regulation), or law and Regulations.

The Shenzhen Regulation provides that two or more concession rights shall be awarded in one sector except if this is not practical due to the limitation of the sector or area.<sup>468</sup> Further, the Xinjiang Regulation prohibits the transfer of public ownership rights to private operators, except for terminal facilities in water, gas or heating supply, or means of public transportation of small or medium capacity.<sup>469</sup> This is a means to restrict the concession right, and curb the local practice of simply selling the public facilities to a private operator at a cheap price to relieve the government of a financial burden.

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<sup>463</sup> Xinjiang Regulation, Art. 10.

<sup>464</sup> Beijing Regulation, Art. 10.

<sup>465</sup> Shenzhen Regulation, Art. 12; and Beijing Regulation, Art. 4.

<sup>466</sup> Shenzhen Regulation, Art. 12 ; and the old Beijing Government Provision, Art. 3.

<sup>467</sup> Xinjiang Regulation, Art. 13.

<sup>468</sup> Shenzhen Regulation, Art. 11.

<sup>469</sup> Xinjiang Regulation, Art. 25.

### 3.5.2 The procedures for selecting the concessionaire

Successful delivery of a concession project depends on whether an appropriate concessionaire is selected. Therefore, the selection procedure lies at the heart of a Concession Regulation; international organisations all prefer competitive selection procedures.<sup>470</sup> Competitive procedures not only help to achieve value for money for both the contracting authority and the general public users of the infrastructure, but also help to prevent corruption. All Chinese Regulations establish as a principle the need for fair and competitive selection procedures, and some accord a preference for an open bidding procedure.<sup>471</sup> However, many regulatory issues remain to be addressed concerning the selection procedure, due to limited regulatory experience and other reasons.<sup>472</sup>

One of the legislative issues to be addressed is what award procedures are to be included in the new Regulation and how to apply them in certain specific situations, a seemingly simple but in fact rather complex issue for all legislators.

The Xinjiang legislators consider it be a simple job, and the Regulation provides for ‘tendering and other fair procedures’ for the selection of concessionaire.<sup>473</sup> The Shenzhen Regulation has substantially changed its policy on legislative design of concession award procedures from that in the old government provision. The old government provision contains three procedures for the award - tendering, auction and ‘Zhao Mu’,<sup>474</sup> which means solicitation, but in

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<sup>470</sup> For example, UNIDO, ‘Guidelines for Infrastructure Development through Build-Operate-Transfer (BOT) Projects’ (Vienna: UNIDO, 1996), at p.96. International Bank for Reconstruction and Development, ‘Procurement under IBRD and IDA Loans’ (Washington, D.C: World Bank, 1996), at para. 3.13(a); UNCITRAL Guide at para.98.

<sup>471</sup> Shenzhen Regulation, Art. 8.

<sup>472</sup> See the following discussion in section 4.3.

<sup>473</sup> Xinjiang Regulation, Art. 10.

<sup>474</sup> The term ‘*zhao mu*’ is literally used in the Chinese context, in personnel management practice, to mean the ‘recruitment’ of talent or, in fund management, practice as ‘solicitation’ for funds. The invention of this legal term in the earlier government provision is supposed to be a combination of limited tendering and the idea of private solicitation for funds (with little public disclosure of information), which is presumably a negotiation procedure with little transparency and competition. During the legislative process in the Municipal Congress, there was



practice means a negotiated procedure - and each was accorded equal status in its application. The new Regulation prefers use of ‘such fair and competitive procedure as tendering and auction’, except when this is not practical, in which case the Open *Zhaomu*, the negotiated procedure, may be used.<sup>475</sup> The second change is that ‘*Zhao Mu*’, the negotiated procedure, was substantially improved upon in terms of transparency and, arguably, competition. First, there is presumably a requirement of justification for the use of the procedure of *Zhao Mu*; secondly, the conditions and procedure to be followed as part of this procedure must be made in advance and published; thirdly, an evaluation committee must be specifically set up for each case, to ensure some degree of objectivity in choosing the preferred candidate with which to finalise the negotiation.

The earlier government provision in the Beijing Regulation requires that the tendering procedure be used in selecting a concessionaire, except in a limited situation where concession may be delegated directly, presumably to the incumbent SOEs. During the new legislation process, there was a consensus among the working group members that the requirement for a tendering procedure is too rigid.

Thus consideration was given to designing some more flexible procedures to reflect both regulatory requirements and commercial reality. Two options were seriously considered in this regard. One was the awarding procedures proposed in the UNCITRAL Guide,<sup>476</sup> and the other was the solicitation procedure invented in the Shenzhen Government provision. In a draft proposal presented to the Municipal Government by the working group, ‘public solicitation’, an improved Shenzhen version of ‘solicitation’, was proposed, with the considerable enhancement of transparency requirements that can be seen now in the Shenzhen Regulation. However, there were two different views on the award procedures among decision-makers: one view preferred to maintain the position of tendering in the old government provision, and the other argued for more flexibility in the Regulation. The final provision reflects a compromise, requiring the contracting authority to use ‘tendering and other forms of fair and

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much pressure to improve the transparency and competition of this procedure, and the procedure was substantially improved in the new Regulation.

<sup>475</sup> Shenzhen Regulation, Art. 8.

<sup>476</sup> UNCITRAL, UNCITRAL Legislative Guide on PFIP, (Fifty-fourth session, Supplement No. 17, New York: United Nations, 2001), Pt III, selection of concessionaire, and the Model Provisions accompanied therein, Arts 10–19.

competitive procedures' in concessionaire selection.<sup>477</sup> It is worth noting that the method of direct contracting or delegation was fortuitously removed, a symbol that the legislators may not want to accord incumbent SOEs any special treatment when awarding the concession.

### **3.6 The legal framework for the concession agreement and the structure of rights and obligations**

The concession agreement is a legal instrument through which the public and private relations are defined, and rights and obligations are balanced. In the absence of concession laws, a mechanism of regulation through a contract is generally employed to protect the legitimate interest of the concessionaire and safeguard the public interest. Whereas the concession law is general, much of the work of regulation is also maintained through the concession agreement. Though the content of the concession agreement depends on the negotiation involved in each case, the agreement is generally aimed at achieving a balance of interests between the parties concerned.

#### **3.6.1 The balance and structure of rights and obligations**

The legal framework of both the regulation and the concession agreement are structured to achieve a balance of interests between the parties concerned. The Regulations generally provide for the basic rights and obligations in the Preamble, and these are then followed in detail throughout the Regulations.

##### **3.6.1.1 Rights of concessionaire**

One basic right of the concessionaire is to invest, construct, and operate the infrastructure facility, and provide relevant services to the general public according to the scope of the concession. By doing so, the concessionaire also enjoys the right to charge fees to the service users as a means to compensate it for its cost in providing the service. It also has the right to government subsidies and other related interests promised by the government, depending on the substance of the agreement. Besides, it has a right to compensation in case of a

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<sup>477</sup> Beijing Regulation, Art. 11.

government policy change or a government breach of contract. In case of grievance, it also has the right to resort to formal proceedings for remedies.

### **3.6.1.2 Main concessionaire obligations**

The Regulations generally impose some basic obligations on the concessionaire which are crucially important to safeguard the public interest.

#### **3.6.1.2.1 The obligation to provide essential public service effectively**

An essential concessionaire obligation under the agreement is to provide a safe and high-quality product or service, and to do so effectively.<sup>478</sup>

In order to fulfil this obligation, the concessionaire must also provide a universal and non-discriminatory service to the consumers within the area defined by the concession agreement.<sup>479</sup> When new users request connection to the infrastructure facilities supplying water, gas or heating, or for sewage disposal, the concessionaire operating such facilities may not charge them connection fees.<sup>480</sup> A concessionaire also undertakes to provide the service in a continuous way. Even in the case of a take-over on the basis of a government decision or provision in the agreement, the obligation of maintaining the infrastructure facility bona fide and normal service is not fulfilled until the take-over is complete.<sup>481</sup> Meanwhile, related to its obligation to provide continuous service, the concessionaire must maintain an emergency plan to ensure the normal operation of the infrastructure, to the maximum extent possible, in the case of natural disaster, war, accidents, and such public incidents as public sanitary and security

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<sup>478</sup> Beijing Regulation, Art. 19; Xinjiang Regulation, Art. 5; Shenzhen Regulation, Art. 4.

<sup>479</sup> Beijing Regulation, Art. 20; Xinjiang Regulation, Arts 5 and 21; Shenzhen Regulation, Art. 34.

<sup>480</sup> Beijing Regulation, Art. 20; Xinjiang Regulation, Art. 26; Shenzhen Regulation, Art. 29.

<sup>481</sup> Beijing Regulation, Art. 21; Shenzhen Regulation, Art. 36.

crises.<sup>482</sup> Concessionaires are also obliged not to abuse their concession rights to impinge on the legitimate rights of consumers.<sup>483</sup>

#### **3.6.1.2.2 The obligation to pay a concession fee and implement government set price**

A concessionaire is also obliged to pay a concession fee to the contracting authority when it is awarded the concession right; the fee may be waived depending on the particular situation or sector.<sup>484</sup> The concessionaire also undertakes to charge user fees at a rate set by the government through an open procedure.<sup>485</sup>

#### **3.6.1.2.3 An obligation to maintain the public facilities**

Another obligation related to the provision of an infrastructure service is to maintain the infrastructure well. To fulfil this obligation, the concessionaire must undertake regular checks, maintenance and regeneration of the infrastructure; must ensure its sound operation; and must report on the conditions of operation to the contracting authority.<sup>486</sup>

The concessionaire is also under an obligation not to dispose of the concession or related assets without the prior consent of the contracting authority, regardless of whether this disposal is in the form of assignment, lease, security, or any other forms.<sup>487</sup> In addition, the concessionaire may not use the project facilities or related land beyond the purpose of the project.<sup>488</sup>

#### **3.6.1.2.4 Obligation to accept supervision and disclose information**

A fourth concessionaire obligation is to accept supervision from competent authorities, and to undertake to disclose information concerning the service or product, or the infrastructure facilities and

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<sup>482</sup> Beijing Regulation, Art. 34.

<sup>483</sup> Shenzhen Regulation, Art. 27.

<sup>484</sup> Xinjiang Regulation, Art. 22; Shenzhen Regulation, Art. 20.

<sup>485</sup> Xinjiang Regulation, Art. 20; and Shenzhen Regulation, Art. 38.

<sup>486</sup> Beijing Regulation, Art. 26; Xinjiang Regulation, Art. 23; and Shenzhen Regulation, Art. 32.

<sup>487</sup> Beijing Regulation, Art. 25.

<sup>488</sup> Art. 25 of Beijing Regulation; Art. 25 of Xinjiang Regulation' Arts 24 and 28 of Shenzhen Regulation.

their operation.<sup>489</sup> This is especially essential to assist the government in supervising the operation of the concession activities. To fulfil this obligation, the concessionaire is not only obliged to report to the contracting authority concerning its regular checks, and maintenance and regeneration of the infrastructure, but also to file to the contracting authority, in a timely and complete manner, its current annual operation report, annual financial report and other affairs of importance,<sup>490</sup> which may include changes to the enterprise's name and address or changes to top management.<sup>491</sup> In addition, the concessionaire is obliged to collect, classify and keep a file of, all relevant materials concerning the construction, operation, repair and maintenance, and transfer this to the contracting authority in the manner and procedure and for the duration defined in the concession agreement.<sup>492</sup> Concessionaires are also obliged to publish information on public interest and security concerns such as service quality, technical standards,<sup>493</sup> and its audited financial report for the previous year.<sup>494</sup> To ensure day-to-day supervision, one Regulation requires the concessionaire to improve its IT management system and have it connected to the regulatory authority.<sup>495</sup>

### **3.6.1.3 The main governmental obligations**

The Beijing Regulation generally provides that the contracting authority shall fulfil its obligations in accordance with the concession agreement, and other relevant authorities shall, within their competence, honour their promises provided in the agreement.<sup>496</sup> Therefore, government obligations in a concession arrangement depend on the particular provisions in the agreement.

However, the Regulations do provide for certain key governmental obligations to protect the investor's interest. For example, as a general principle, the Xinjiang Regulation provides that the contracting authority must undertake to adhere to a general principle that it will be open, fair and equitable; that it will take into

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<sup>489</sup> Shenzhen Regulation, Art. 23.

<sup>490</sup> Beijing Regulation, Arts 26 and 28; and Shenzhen Regulation, Art. 32.

<sup>491</sup> Beijing Regulation, Art. 28; and Shenzhen Regulation, Art. 25.

<sup>492</sup> Beijing Regulation, Art. 27.

<sup>493</sup> *ibid.*, Art. 39.

<sup>494</sup> Shenzhen Regulation, Art. 26.

<sup>495</sup> *ibid.*, Art. 33.

<sup>496</sup> Beijing Regulation, Art. 19.

account the public interest as precedence in the award of concession; and that it will also protect the legitimate rights of the concessionaire.<sup>497</sup> The Government may not cancel or restrict the concession right provided in the concession agreement unless there is a legitimate reason of public interest, in which case compensation shall be provided.<sup>498</sup> In addition, the contracting authority, including its staff, is also under an obligation to keep confidential the commercial secrets of the concessionaire learned in the course of project operation and supervision.<sup>499</sup>

The Regulations also confirm the Government's obligation to compensate for loss caused by government acts such as: government withdrawal of the concession; termination of agreement; acquisition of the concession facility in the name of public interest;<sup>500</sup> and change of policy.<sup>501</sup> If the level of user fee is set by the government, concessionaires may also ask for compensation when the reimbursement cannot cover their investment during the concession period in the normal course of operation. However the conditions for such compensation, and method and base for its calculation, shall be agreed in the Agreement.<sup>502</sup>

The supervisory authority is also under an obligation not to interfere in the normal operation of the concessionaire when it is conducting supervision and evaluation.<sup>503</sup> In addition, under the Shenzhen Regulation, the supervisory authority is obliged to keep an emergency plan in place to ensure the steady and continuous supply of public products and services in the event of irregularities specified the Regulation.<sup>504</sup>

### **3.6.2 Duration and extension of the concession**

The duration of the concession is to be provided for in the concession agreement depending on the nature of the sector, the scope of project, the form of the concession and other relevant factors, but in no case

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<sup>497</sup> Xinjiang Regulation, Art. 4.

<sup>498</sup> Beijing Regulation, Art. 32; and Xinjiang Regulation, Art. 27.

<sup>499</sup> Beijing Regulation, Art. 29.

<sup>500</sup> Beijing Regulation, Art. 32; and Xinjiang Regulation, Art. 33.

<sup>501</sup> Beijing Regulation, Art. 30.

<sup>502</sup> Xinjiang Regulation, Art. 24.

<sup>503</sup> Beijing Regulation, Art. 36; and Shenzhen Regulation, Art. 52.

<sup>504</sup> Shenzhen Regulation, Art. 50.

shall last for more 30 years.<sup>505</sup> However, the concessionaire may request an extension of the concession period subject to the evaluation and approval of the municipal government.<sup>506</sup>

### **3.7 The regulatory institution**

#### **3.7.1 Regulators and their duties**

##### **3.7.1.1 The regulator**

One key issue concerning the regulatory institution is whether one separate regulatory body, either comprehensive or sector-specific, independent of the contracting authority, is established to supervise the whole process of the concession. It seems difficult to maintain an arm's length between these two authorities at this early stage of the Chinese Regulations. For example, under the Xinjiang Regulation, the contracting and regulatory functions are held by the same government authority.<sup>507</sup>

It appears that the Shenzhen Regulation achieves some distance between the two authorities by placing the contracting function with the municipal government, and the regulatory function with the competent sectoral department in charge of utilities.<sup>508</sup>

In the case of the Beijing Regulation, it was initially conceived within the cross-government working group that the BMDRC, which is not a contracting authority itself, could play a major role as a regulator. However, it seems that more of a consensus is needed for such an endeavour. Therefore, the Regulation maintains the status quo of the administrative structure as a supervision mechanism; this provides that the relevant departments of the administration shall conduct checks, reviews, and audit within their competence on the concession.<sup>509</sup> It is further required that contracting authorities: keep records of the concession projects; conduct timely surveillance and analysis of the operation of the projects; and publish periodic (annual or bi-annual) reviews of the operation of the projects.<sup>510</sup> This may indicate that the main regulatory mechanism for the operation of the

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<sup>505</sup> Beijing Regulation, Art. 13.

<sup>506</sup> Beijing Regulation, Art. 22.

<sup>507</sup> Xinjiang Regulation, Art. 7.

<sup>508</sup> Shenzhen Regulation, Art. 6.

<sup>509</sup> Beijing Regulation, Art. 35.

<sup>510</sup> *ibid.*, Art. 36.

concession is the regulation through the contract by the contracting authority. However, the BMDRC may still play an important regulatory role in the concession project. This is partly because of its traditional role in regulating price, and partly because one more function of ‘supervision’ was added to the Article concerning administrative co-ordination during the concession before the Regulation was finally passed.<sup>511</sup> This function which could be defined broadly as *supervision* of the whole concession process including deciding a concession project, awarding process, and operation period, but alternatively as narrow as simply a recognition of its traditional role in regulating price.

### 3.7.1.2 Duties of the regulator

The Regulations seem to place the regulatory duties with the utilities or sectoral authority. However, this perception is misleading since many regulatory functions, such as price and environmental Regulations, are with other authorities. It would appear to be best practice, therefore, to specify the duties of the newly established regulator to avoid confusion and inconsistency. The Shenzhen Regulation in this regard has provided some insights into the typical functions that the regulator is supposed to perform, namely:<sup>512</sup>

- (1) Specifying the quality standard of public products and services, and supervising and checking the quality of the product and service provided by the operator.
- (2) Supervising the operator’s performance of obligations provided in the authorization certificate and agreement.
- (3) Handling the subject of consumer complaints.
- (4) Advising on the concessionaire’s operational plan and supervising its implementation.
- (5) Reviewing the operator’s annual report.
- (6) Reporting to the Municipal Government over the annual supervisory report of the operator.
- (7) Taking over the operation of utilities in case of emergency.

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<sup>511</sup> Beijing Regulation, Art. 6.

<sup>513</sup> Xinjiang Regulation, Art. 17; and Shenzhen Regulation, Art. 39.



- (8) Assisting the competent price authority to prepare the price plan.
- (9) Other duties provided by law and Regulations.

### **3.7.2 Price regulation**

The price of utilities products and services in China is generally regulated by the Chinese Price Law (CPL). This provides that the Government may, as necessary, fix or provide guidelines for the pricing of public utilities' products and services when the product or service is of significance to national economic development and people's lives, or when the provision of the product or service is the subject of a monopoly. The Regulations further provide, within the framework of the Chinese Price Law, for issues concerning the price regulator, government pricing, the principle governing pricing and the formation of price, the periodic price review mechanism and the price hearings system.

#### **3.7.2.1 The price regulator**

The Regulations confirm the current system of price regulation established by the CPL, which lays out the authority and procedure for formulation, adjustment and supervision of price. While recognising the current price regulation framework, the Regulations also require the supervisory authority to assist the competent price authority to verify and supervise the operational cost, and to prepare the price plan for the municipal government's approval.<sup>513</sup>

#### **3.7.2.2 Prices set by the government**

The Regulations reiterate the operator's obligation to charge user fees at a rate set by the Government, or by following the Government's direction when delivering the product or service to the public.<sup>514</sup>

#### **3.7.2.3 Principles to set the price and formulation of the price**

The Regulations also provide for the principle by which the fixed or guided price is formulated - a mixture of compensation for cost,

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<sup>513</sup> Xinjiang Regulation, Art. 17; and Shenzhen Regulation, Art. 39.

<sup>514</sup> Beijing Regulation, Art. 23.

reasonable return on investment, conservation of resources, and proportionality to social endurance.<sup>515</sup>

### **3.7.2.3.1 The principle of compensation for cost**

There is a general requirement in the Regulations that the price should be formulated based on the principle of compensation for the cost of providing the public products and services.<sup>516</sup> By the principle of cost compensation, the operational cost should be based on the average social cost, and those costs irrelevant to the concession product and service may not be included.<sup>517</sup> There is also a requirement for the price regulator to entrust a qualified auditor with the task of auditing the operator's cost and investigating the average social cost,<sup>518</sup> and to hold a public hearing before a price adjustment plan is accepted.<sup>519</sup>

### **3.7.2.3.2 The principle of reasonable profit**

There is a general provision on the level of profit for the operator, the principle of reasonable profit,<sup>520</sup> which indicates that excessive profit in public service provision is unlawful. However it is not an easy job to determine what is a reasonable profit and, as such, this is an area where further guidance is required.

### **3.7.2.3.3 The principle of proportionality to social endurance**

A pricing policy needs also to take into consideration social factors. Some Regulations require the competent price authority to conduct a 'social endurance' investigation and to hold public hearings before a new price is set.<sup>521</sup> The Government may also wish to direct the operator to provide products and services to disadvantaged groups. In this case, the requirement must be specified in the bidding document

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<sup>515</sup> Beijing Regulation, Art. 37; Xinjiang Regulation, Art. 17; and Shenzhen Regulation, Art. 40.

<sup>516</sup> Shenzhen Regulation, Art. 14; and Xinjiang Regulation, Art. 18.

<sup>517</sup> Xinjiang Regulation, Art. 18; and Beijing Regulation, Art. 37.

<sup>518</sup> Shenzhen Regulation, Art. 42.

<sup>519</sup> Shenzhen Regulation, Art. 45.

<sup>520</sup> Xinjiang Regulation, Art. 17; Beijing Regulation, Art. 37; Shenzhen Regulation, Art. 40.

<sup>521</sup> Shenzhen Regulation, Art. 45.

and the concession agreement; when an operator suffers a loss due to following this social policy, it has the right to government compensation.<sup>522</sup>

In addition, the Shenzhen Regulation also requires the operator to maintain the price at a relatively steady level and the government may set up a special fund for the purpose of price regulation.<sup>523</sup>

#### **3.7.2.3.4 The principle of resource conservation**

This principle is set out in the Beijing Regulation and it requires the price regulator to take into consideration environmental factors in its pricing policy. This is particularly the case in Beijing, where water and other resources are limited, and pricing decisions generally incorporate environmental factors.

#### **3.7.2.4 Price review and the public hearings system**

The Beijing Regulation requires that the competent price authority set up a cost databank and a periodic price review mechanism to conduct effective price regulation of the service or product provided by the concessionaire.<sup>524</sup> A similar requirement can be found in other Regulations being discussed.<sup>525</sup>

### **3.7.3 Regulatory tools**

#### **3.7.3.1 Compulsory information disclosure and evaluation**

Information provides the basic tools for effective regulation. The Beijing Regulation provides an obligation for information disclosure by the concessionaire to both the government authority,<sup>526</sup> and the public.<sup>527</sup> In addition, some systems also depend on a regulator's review and evaluation mechanism to ensure effective regulation. For example, the Beijing Regulation requires that the contracting authority keeps records for the concession projects as a basis for supervision,

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<sup>522</sup> Xinjiang Regulation, Art. 21.

<sup>523</sup> Shenzhen Regulation, Art. 48.

<sup>524</sup> Beijing Regulation, Art. 38.

<sup>525</sup> Xinjiang Regulation, Art. 19; and Shenzhen Regulation, Art. 42.

<sup>526</sup> Beijing Regulation, Arts 26, 27 and 28.

<sup>527</sup> *ibid.*, Art. 39.

and that it conducts timely surveillance and analysis of the operation of the concession projects, a periodic comprehensive review, and evaluation of the concession projects.<sup>528</sup> It also provides effective tools to ensure proper project operation. A similar evaluation mechanism is also found in the Xinjiang Regulation.<sup>529</sup> It can be generalised that, while the Shenzhen Regulation mainly relies on information disclosure and the Xinjiang Regulation on evaluation, Beijing employs both means to ensure effective regulation. In addition, considering the importance of the regulatory function, it is also worthwhile to consider a periodic evaluation on the effectiveness of the regulatory institution itself, to ensure that government improves the system in a timely manner to achieve the regulatory objectives. During the legislative process for the Beijing Regulation an attempt was made to include a requirement for this, but this failed.

### **3.7.3.2 Compulsory administrative enforcement mechanisms**

Another regulatory tool consists of compulsory administrative enforcement mechanisms, including those aimed at operators and regulators themselves.

#### **3.7.3.2.1 Administrative penalties**

An example of such an administrative mechanism relating to operators can be found in the Shenzhen Regulation, which includes directives on both correction within a designated time, and cancellation of the concession rights. Conduct giving rise to such administrative enforcement measures includes: obtaining the concession rights through improper means; serious breaches of contract; and unlawful conduct.<sup>530</sup>

#### **3.7.3.2.2 Regulation of the contracting authority and regulators**

The Xinjiang Regulation provides an example of regulatory measures directed towards contracting authorities and regulators, as a compulsory administrative enforcement mechanism.<sup>531</sup> Conduct that

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<sup>528</sup> *ibid.*, Art. 36.

<sup>529</sup> Xinjiang Regulation, Art. 29.

<sup>530</sup> Shenzhen Regulation, Art. 55.

<sup>531</sup> Xinjiang Regulation, Art. 39.

can lead to such administrative measures includes, but is not limited to:

- (a) ignorance of qualified concession applications and extension requests;
- (b) neglect of legal duties in publishing notices, keeping records, verifying compensation requests, handling extension requests, etc.;
- (c) not selecting the concessionaire through bidding, or selecting through false bidding;
- (d) neglect of the duty of supervision on operators or not conducting an evaluation of the concession's operation;
- (e) not accepting supervision or enquiries from the supervisory committee, or not listening to the comments and advice of the supervisory committee; and
- (f) unlawful cancellation of the concession rights or unlawful termination of the concession agreement.

### **3.7.3.3 Public participation in regulation**

As the consumer of public products and services, the general public is a key stakeholder in the concession project. In addition, the ultimate goal of concession regulation is to maximum the welfare of consumers of public products and services. Therefore, the general public should be accorded the rights to participate in concession project decisions and to play an important role in concession regulation. Some Chinese Concession Regulations have achieved encouraging developments in public participation in key concession decisions and regulation, although the development is not so successful in certain Regulations.

In the Beijing Regulation, for example, the early draft envisages a greater role for public participation in the concession process, for example, in deciding a concession project, through the publication of the results of the annual review of the operation of the project; and in establishing an appropriate mechanism to facilitate public participation. However, these provisions were unfortunately dropped, and the law itself only provides for an obligation on the concessionaire to publish to the public information of public interest and information on safety concerns.<sup>532</sup>

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<sup>532</sup> Beijing Regulation, Art. 39.

In contrast with the Beijing Regulation, however, many of the ideas of public participation proposed in the Beijing Regulation are realised in the Xinjiang and Shenzhen Regulations.

Firstly, these Regulations confirm the fundamental rights for public service users,<sup>533</sup> as are accorded to consumers by the Chinese Consumers Law. These include the right to know, the right to provide comments and advice, and the right to challenge conduct and lay a complaint when legitimate rights are impinged.

Secondly, these Regulations establish new mechanisms to ensure an effective public role in concession regulation and key decisions. Both Regulations require the establishment of a mechanism to facilitate public participation in regulation;<sup>534</sup> these are the Supervisory Committee for Concession (SCC) in the Xinjiang Regulation,<sup>535</sup> and the Public Supervisory Committee for Utilities (PSCU) in the Shenzhen Regulation<sup>536</sup> respectively. These committees are assigned a legal function of supervision over concession activities, representing the general public, and there is also a component requirement for the committee that a minimum of three quarters of its members should be non-government experts and representatives of the general public.

The committee may collect public opinions through public hearings, seminars, questionnaires, etc. and present legislative, regulatory opinions and advice in key concession decisions of public interest.

Contracting authorities, other relevant authorities, and concessionaires are obliged to listen to the opinions and advice presented by the Committee, and a decision not to adopt such opinions and advice must be justified and recorded. A rejection of such supervision and opinions may lead to administrative discipline, or even criminal liability in cases where the rejection results in serious accidents.<sup>537</sup>

In the Shenzhen Regulation, there is an additional requirement for the operator to present an annual report to the Committee concerning its operation.<sup>538</sup>

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<sup>533</sup> Xinjiang Regulation, Art. 8; and Shenzhen Regulation, Art. 5.

<sup>534</sup> *ibid.*

<sup>535</sup> Xinjiang Regulation, Art. 30.

<sup>536</sup> Shenzhen Regulation, Art. 51.

<sup>537</sup> Xinjiang Regulation, Art. 39.

<sup>538</sup> Shenzhen Regulation, Art. 51.

Thirdly, these Regulations require public participation in key concession decisions. For example, the Xinjiang Regulation requires public opinion to be heard through public hearings or other open means of consultation.<sup>539</sup> All Regulations require public hearings to be held before a pricing decision is made.<sup>540</sup> Representatives of the general public may also participate in the evaluation of the concession's operation.<sup>541</sup> Under the Shenzhen Regulation, operators are obliged to publish to the public their audited financial statements.<sup>542</sup>

#### **4. The emerging regulatory framework for future PFIP in China: current**

Regulation in procurement of privately financed infrastructure reflects a recent global trend in private provision of infrastructure and utilities service.<sup>543</sup> However, can the current Regulations provide an adequate legal framework for PFIP? A current report on the Quality of Concession Legislation In Early Transition Countries presents a general scenario and offers comments:

It is fair to observe that there is a tendency to avoid a comprehensive and transparent legal framework by adopting sub-law level regulations or decrees governing individual concessions, thus allowing a case-by-case approach. While such an approach is ultimately a matter of policy, it has some clear disadvantages in that it lacks stability, transparency, and unified applicability to all participants, thus lacking measures combating potential corruption. In addition to developing further legal and policy frameworks, all of the Early Transition Countries need to build up a solid institutional infrastructure

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<sup>539</sup> Xinjiang Regulation, Art. 10.

<sup>540</sup> Xinjiang Regulation, Art. 19; and Shenzhen Regulation, Art. 45.

<sup>541</sup> Xinjiang Regulation, Art. 29.

<sup>542</sup> Shenzhen Regulation, Art. 51.

<sup>543</sup> A brief discussion is provided on the evolution of the role of public and private sector in developing infrastructure in history. See UNCITRAL Guide.

capable of designing and implementing individual PPP projects. [Translation].<sup>544</sup>

The Chinese legislation on concessions has apparently gone beyond the phase of case-by-case regulation towards a more comprehensive stage of regulation. Despite the different features of each Regulation, the Regulations discussed here, as a whole, could contribute to an emerging legal framework for Chinese PFIPs.

## **4.1 Regulatory objectives**

### **4.1.1 The achievement of the objective of balance of interest**

As discussed above, one of the regulatory objectives established in the current Regulations is the balance of various interests. However, the achievement of this objective has limitations. Without an appropriate political and policy environment, and improved procurement techniques, the Government's objective of choosing a responsible concessionaire will be discouraged, and the Government may be exploited by private sector opportunism and desire for excessive profit, which is not difficult to observe in the Chinese context. Alternatively, the legal arrangement may be unfair to the private operator. A report has provided an adequate observation:

A reverse and not infrequent case (more difficult to flag) is a project with sound economics but implemented under a badly conceived PPP agreement [emphasis added]. In this case, there is a high chance that the PPP fails to achieve its objectives: either it does not yield value for money for society because the private sector makes excessive profits out of it; or it is so unfair to private investors (even if a limited number of stakeholders may have made substantial benefits) that, although looking attractive to the public sector, it eventually generates significant costs, direct - default, renegotiation - and indirect - negative impact on future

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<sup>544</sup> European Bank for Reconstruction and Development Office of The General Counsel, Report on the Quality of Concession Legislation in Early Transition Countries, June 2005 at <[www.ebrd.com/country/sector/law/index.htm](http://www.ebrd.com/country/sector/law/index.htm)> accessed 30 November 2010.



PPP business. One or two cases of this kind are usually enough to raise scepticism among citizens and investors about PPPs.<sup>545</sup>

The balance of various interests is generally reflected in the concession agreement, despite the fact that this balance and its certainty depends greatly on the selection process and contract negotiation. The above comment reveals the importance of a sound procurement mechanism conducive to an agreement with an appropriate balance of various interests, without which public-private relations will be vulnerable to collapse, and the objective of the PPP model will be discouraged.

#### **4.1.2 The objective of marketisation: PFIP decision and SOEs**

As is discussed above, one debated objective during the legislation was the objective of infrastructure marketisation. Some Regulations establish this as a regulatory objective, while others do not. However, the attainment of this objective is also limited depending on other infrastructure policies, especially those concerning state owned enterprises (SOEs) operating in the infrastructure or utilities sectors.

One distinctive feature of the current Regulations is that it only applies when the infrastructure project is provided through a concession. Therefore, from an extreme perspective, the Regulations will never be applied at all if the Government does not choose to employ the means of a concession for infrastructure services. Traditionally, the Government also employs SOEs to provide public services. It could be observed that this is the prevailing model of public service provision in the infrastructure and utilities sectors currently in China, and this model seems to be expanding drastically in the urban infrastructure sector.<sup>546</sup> Several policy issues arise here pertinent to a concession decision.

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<sup>545</sup> P. Boeuf, 'Public-private Partnerships for Transport Infrastructure Projects Annex 1', paper delivered at 'Transport Infrastructure Development for a Wider Europe', Paris, November 27–28, 2003.

<sup>546</sup> The National Development Bank, followed by other commercial banks, has been promoting a business of 'bundling credit loan' to a municipal government. As part of the arrangement, the municipal government is generally required to set up a SOE to serve as the municipal government's platform for finance and investment. The municipal government then delegates the development of the government owned land property to the SOE, and the SOE borrow loans from the

First, are SOEs an extension of government arms or public service providers like their private counterparts? The answer may relate to different policy issues. When they *are* arms and policy tools of the bureaucracy, the pertinent policy issue is corporate reform of SOEs; when they are service providers like their private counterparts, the issue is similar to that of the Government employing a private sector concessionaire. It could be observed that many of the SOEs in the infrastructure and utilities sectors are actually operating on commercial lines and their investment in infrastructure project is mostly based on loans from commercial banks, which renders the project itself a privately financed infrastructure project. Provision of PFIP through SOEs may arguably leave the government with more means of control, through appointment of management, for example. However it is doubtful that they can deliver quality services and best value for money without adequate market pressures. The scandal involving the Beijing Fifth Ring Road provision could provide a good footnote to this argument.<sup>547</sup>

Another policy issue concerning SOEs that may discourage the marketisation objective of the Concession Regulations is that SOEs may enjoy privileges in bidding for the PFIP. Ensuring a level playing field for all potential bidders in a particular concession project has not been brought up as a regulatory issue.

## **4.2 Determination of PIP**

When a concession project is decided, the preparation and approval of PIP becomes a key regulatory issue. However, governments are generally weak in dealing with PIP and other contracting issues. Thus some checks and co-ordination within the governments may be desirable; in which case, the Beijing Regulation may be a good model for future regulation. Besides, the allowance of public participation at this stage may help achieve good policy, in which case the Xinjiang Regulation may prove to be a good reference for future regulation.

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Bank under the framework of ‘bundling credit loan’. It is observed that this practice has encouraged the establishment of more SOEs by local governments.

<sup>547</sup> The Beijing 5th Ring Road was provided by a SOE controlled by the Municipal Government based on bank loans. However, audits found that the cost for the construction of the road was excessively high and a later investigation disclosed a number of corruption cases.

### 4.3 The awarding procedure: further regulatory issues

There are several regulatory issues pending, which either require further regulation or implementation rules, or skilful legal explanation of current laws and Regulations. The first one concerns the governing of the Chinese Bidding Law (CBL).<sup>548</sup> On the one hand, the CBL claims to apply to all bidding activities within the territory of China;<sup>549</sup> on the other hand, however, the rigidity of CBL may not be appropriate to satisfy the requirement of complex concession project procurement. Possible options to solve this problem include: a restrictive explanation of the scope of coverage for the Chinese Tendering Law; amendment to the CBL; and designing a separate tendering procedure for concession projects in future national legislation.

Secondly, another regulatory issue concerns ‘other’ fair and competitive procedures which could be employed to select concessionaires under both the Xinjiang and Beijing Regulations. The two Regulations simply say nothing as to what the ‘other’ procedures are, or the conditions for their application. The lack of regulation of such important issues can give wide discretion to the contracting authority. For example, some of the concessionaires in one PPP project in Beijing have been observed to be selected *de facto* through competitive negotiation despite the legal requirement for tendering.<sup>550</sup> Therefore, this ‘other awarding procedures’ is an important area for future regulation or specification. Other possible options are the design of new procedures following the advice in the UNCITRAL Guide;<sup>551</sup> competitive or sole source negotiation provided for in the Chinese Government procurement law; or the public solicitation provided in the Shenzhen Regulation, albeit that the last requires

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<sup>548</sup> For a detailed discussion of the Chinese Bidding Law, see C. Fuguo, ‘China’s Government Procurement Reform: From Tendering Law to the Public Procurement Law’, in S Arrowsmith and M. Trybus (eds.), *Public Procurement: The Continuing Revolution* (London: Kluwer Law International, 2003); J. Tian, ‘Public Procurement in China: The Way Forward’ (2001) 10 *Public Procurement Law Review* 207; P. Wang, ‘China’s Evolving Legal Framework on Public Procurement’ (2004) 13 *Public Procurement Law Review* 285.

<sup>549</sup> Art. 2.

<sup>550</sup> A strong argument was made in the case that the project could not practically be implemented by following the formal procedure of tendering.

<sup>551</sup> UNCITRAL Guide.

much improvement itself. Another option is to specify such ‘other’ procedures in the PIP documentation to satisfy the legal requirement for fairness and competition.

The third issue is related to the awarding procedure when an unsolicited offer is involved. Recognising the need for practice in reality to reflect good policy concerning unsolicited offers, the UNCITRAL Guide provides detailed discussion and advice and possible legal options concerning this issue for enacting states.<sup>552</sup> The discussion in the UNCITRAL Guide is relevant to the Chinese context in that many infrastructure or utilities projects awarded are, in reality, based on unsolicited offers from the private sector. During the discussions on the Beijing Regulation, this issue was brought up to the working group and later a design following the UNCITRAL Guide was placed in the draft Regulation by the present author. However the issue seemed too novel to many, and enacting such provisions will have to wait for the future.

To sum up, despite the fact that current Regulations have provided competitive procedures for concessionaire selection, there are still many areas to be regulated in the future; this renders the implementation of these laws unpredictable to a considerable degree, and may have a negative impact on the transparency of concessions. One of the ways to fill the gap is to provide detailed procedures in the PIP documentation and test whether these specifications satisfy the legal requirement for fairness and competition (this could be done through public hearings or by another part of the Government apart from the contracting authority). However, this is a case-by-case solution and it is doubtful that the contracting authorities will have sufficient incentives to invoke such a solution. Another solution would be to provide detailed soft or hard rules concerning such issues, as part of a concerted effort among different government departments. However, such an effort will further challenge the capacity of government co-ordination. Of course, there is still a third option open, to regulate such issues in future legislation.

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<sup>552</sup> Section E on unsolicited proposals of Pt III on the selection of concessionaire, UNCITRAL Guide. Articles 20–23 of the Model Provisions attached to the UNCITRAL Guide.

#### **4.4. Public service providers**

It seems that a consensus is reached among current Regulations concerning the fundamental obligations of concessionaires to provide essential services. This is helpful in both attaining the objective of PFIP, which, in turn, enhances public confidence in private provision of public services, and reaching the ultimate goal of consumer interests. It is submitted that these provisions will provide models for future legislation. One pending issue is whether a new legal entity for public service providers is needed. Currently, all these service providers are incorporated under the Chinese Company Law and taken to be commercial companies. There seems an inherent conflict of interest between the commercial goal of such commercial companies and their commitment to provide public services. The nature of the new business and the many new obligations existing in the concession laws seems to indicate that there is a need for a new type of company with the special purpose of public service provision, to co-ordinate the inherent conflict of interest. If this is attained, the corporate governance of the service provider itself could also be designed to help satisfy its special purpose of public service provision and the achievement of the objectives of concession legislation.

#### **4.5 Regulatory institution**

Another pending issue for the current Regulations is that the new regulatory institution relies on the current administrative structure, and the regulatory function is not separated from the contracting authority. This indicates that the current regulatory institution is only a transitional arrangement, and that there is a need for future evaluation of the effectiveness of the current regulatory institution, and restructuring of the regulatory functions in future legislation.

In the Beijing Regulation, despite the failure to establish the BMDRC as a comprehensive regulator, the BMDRC is still given certain supervisory function in addition to its traditional role related to infrastructure and pricing regulation. This institutional arrangement, together with its functions related to reform and development, makes the BMDRC an appropriate authority to counteract the possible conflict between the contracting and regulatory functions; review the effectiveness of the transitional regulatory institution; and help build up the government's future regulatory capacity.

Future legislation could further refer to the Beijing Regulation in respect of the regulatory tools that it employs to attain the regulatory objective - both the compulsory disclosure of information and professional evaluation are required under the Beijing Regulation.

On the other hand, both the Shenzhen and Xinjiang Regulations are distinctive in requiring the establishment of consumers' voice committees. Although effective operation of such a new mechanism depends on further support from the Government, for example, in its budget, the two Regulations have provided useful as references for future legislation.

## **5. Conclusion**

Some general observations can be made concerning the third wave of public procurement regulation in China:

First, there has been a positive political and policy development towards a new model of public service provision recently in China. A transformation from self-sufficiency to 'contracting' in public infrastructure and utilities provision has profound implications for the establishment of a transparent, competitive and efficient public service market and a new model of public governance in China.

Secondly, a legal framework favourable to private finance in infrastructure is required for this new model of public service provision. A review of the current Regulations indicates that a new legal framework for private finance in urban infrastructure and utilities has been taking shape in China, and the current Regulations, as a whole, could provide models for future Regulations to some extent.

However, many loopholes also exist concerning some crucial aspects of a sound regulatory system, leaving much room for further co-ordinated efforts among competent authorities in the implementation and for future regulation.

Thirdly, the legal framework alone cannot sustain this fundamental transformation. A new form of governance of public-private partnerships is a prerequisite for the successful delivery of a concession project, in which all stakeholders' interests are involved. Besides, the challenges of the new contracting and regulatory capacity building identified in other transitional economies are generally pertinent to the Chinese context and cannot be neglected. It is finally submitted that the implementation of the Regulations and the effective

delivery of the infrastructure concession project demand an appropriate design and implementation of an institutional infrastructure as well.

## **Part III**

### **Economic perspective and future recommendations**



## Chapter 6

### PPPs in an international legal, economic and political perspective

#### 1. Introduction

This book has dealt with some general legal rules and principles regarding PPPs in the EU, the WTO and China. The legal focus has been on public procurement law on an international, regional and national basis. Other national public procurement rules and regulations will, of course, affect the use and structure of PPPs, but this legal perspective is not included in the book.

The purpose of this chapter is to comment on some of the overall legal challenges that PPP projects will face from a legal and political perspective.<sup>553</sup>

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<sup>553</sup> In regard to e.g. national rules and regulations in the EC Member States, see the EPEC homepage, at:

<http://www.eib.org/epec/link/index.htm?action=changeFormat&format=PRINT> accessed 30 November. EPEC stands for the European PPP Expertise Centre (EPEC), which was launched by the European Investment Bank (EIB) and European Commission on 16 September 2008. EPEC is a collaboration between the EIB, European Union Member and Candidate States, and the European Commission that is designed to strengthen the organisational capacity of the public

The successful procurement and implementation of a PPP depends on the legal public procurement procedures. The contracts between the parties must fulfil the demands of the public procurement law and, as such, there is little flexibility for the parties to negotiate further demands. This is a serious problem. Nutavoot Pongsiri formulates the problem as:

Under a presumption of market incentives, public-private partnerships seem to be more appropriate than hierarchical command relationships or adversarial regulatory processes. Nevertheless, successful implementation of public-private partnership depends to a large extent on the development of sound legal procedures, agreements and contracts that clearly define the relationship between government and private firms.<sup>554</sup>

The first legal challenge in respect to a full use and benefit of PPP is that a PPP often falls under the public procurement rules and legislation, and that none of those rules are set up specifically to cover the purpose of a PPP arrangement.

Instead, public procurement rules and legislation are made with traditional public contracts in mind; these are generally based on different measures to the PPP. The EC Commission does not comment on the problem that a large part of the traditional EC procurement rules in the 2004/18/EC Directive<sup>555</sup> are made to cover the traditional procurement arrangement and not the new construction of co-operation between a public and private party.<sup>556</sup>

The second legal challenge is the overall ban on negotiation in the public procurement law regime. A PPP arrangement is an alternative

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sector to engage in Public Private Partnership (PPP) transactions. EU Member States and candidate countries can share experience and expertise, analysis and best practice relating to PPP transactions.

<sup>554</sup> N. Pongsiri, 'Regulation and public private partnership' (2002) 15 (2) *International Journal of Public Sector Management* 487-495, p. 489.

<sup>555</sup> See Council Directive (EC) 2004/18 on the co-ordination of procedures for the award of public works contracts, public supply contracts and public service contracts [2004] OJ L134/114, as amended.

<sup>556</sup> See Commission (EC), 'Communication on Public-Private Partnerships and Community Law on Public Procurement and Concessions' (Communication) COM (2005) 569 final, 15<sup>th</sup> November 2005, section 2.3.

to a traditional public procurement arrangement. In a PPP, the focus is on co-operation and effectiveness compared to a traditional arrangement. Negotiation is an important issue when two or more parties wish to create a model for co-operation, but the public procurement law does not reflect this need. The reason is to be found in the objectives behind the public procurement law. It needs to be ascertained whether these objectives are strong enough to prevent negotiation, and whether another procedure would be more efficient in regard to PPP?

These legal challenges are interrelated, and the solutions point in the same direction. This will be discussed, and some recommendations will be presented, in this chapter.

## **2. The content of a PPP contract**

In this section some important elements in the PPP contract and collaboration are defined for later use in this chapter.

1. A PPP has a relatively long duration and involves some kind of co-operation between the public partner and the private partner on different aspects of a planned project.
2. The private party will normally finance the project, sometimes by means of complex arrangements between the various players. In some situations public funds can be added to the private funds.
3. The economic operator, who participates at different stages in the project (design, completion, implementation, funding), holds an important role. The public partner concentrates primarily on defining the objectives to be attained in terms of public interest, quality of services provided and pricing policy, and it takes responsibility for monitoring compliance with these objectives.
4. The distribution of risks between the public partner and the private partner is different than in traditional public projects. In a PPP, the risk normally borne by the public sector is transferred to the private party.<sup>557</sup>

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<sup>557</sup> The Commission notes that a PPP does not necessarily entail that the private partner assumes all the risks, or even the major share of the risks, linked to the project. The precise distribution of risk is determined case by case, according to the respective ability of the parties concerned to assess, control and cope with this risk.

5. As mentioned above in this book, a PPP can be characterised<sup>558</sup> as a long-term contract (for a period of 20 to 30 years) between a public authority and a consortium of private parties based on co-operation, aiming to provide a mechanism for developing public service provision involving significant assets or services for a long period of time.
6. The asset or service is entrusted to the private sector, and a part of or all of the funding comes from the private sector. The latter means that the private party in a PPP holds all equity and handles the works, operation and maintenance of the project.<sup>559</sup>
7. The PPP contract focuses on needs and functions,<sup>560</sup> and it must be built on trust, transparency by open books, and co-operation between the parties.

In the end, all of these factors can fulfill the main scope of a PPP agreement, which is to ensure joint utility between the parties, thereby ensuring the most efficient product at the lowest price.

A PPP therefore has more to it than just its financing element. The relationship has to build on co-operation, trust and demands so that the parties can create the best and most efficient product.

Therefore, in a general legal context, a Public Private Partnership (PPP) can be characterised as a long-term contract arrangement between a public authority and a consortium of private parties.

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<sup>558</sup> See Commission (EC), ‘Green Paper on public-private partnerships and Community Law on Public Contracts and Concessions’ (Green Paper), COM (2004) 327 final, 30<sup>th</sup> April 2004.

<sup>559</sup> See S. Arrowsmith, ‘Public Private Partnerships and the European Procurement Rules: EU Policies in Conflict?’ (2000) 37 *Common Market Law Review* 709-737, p. 709; and S. Arrowsmith, *The Law of Public and Utilities Procurement*, (2<sup>nd</sup> edn., London: Sweet & Maxwell, 2005), p. 415. See also Commission (EC), ‘Green Paper on public-private partnerships and Community Law on Public Contracts and Concessions’ (Green Paper), COM (2004) 327 final, 30<sup>th</sup> April 2004.

<sup>560</sup> The private party is responsible for the funding, design, completion, implementation, service, and maintenance. The incentive to build to reduce the cost of service and maintenance in the long run is changed because the PPP concept provides the contractor with a compelling reason to create the cheapest building or infrastructure. In contrast to a traditional public contract, it is the contractor who has the obligation to provide services and operations. The PPP contract must run for a period equal to the time it takes for the private party to regain the investment. This is the main reason for the long duration in PPP projects.

From an inter-contractual perspective, a PPP must be based on co-operation, because the aim of a PPP is to provide a mechanism for developing a public service provision involving significant assets or services over a relatively long period of time. From an institutional perspective, a PPP focuses on turning around the parties' traditional incentives to create more and better value for the tax money,<sup>561</sup> by, for example, basing the contract on needs instead of demands. For example, in a PPP to build a school, the public authority points out the learning strategy, teaching environment and the differences in the learning abilities of pupils instead of specifying numbers of class rooms, etc. As mentioned in chapter two, this is different from a traditional public procurement project. In a PPP, such reflections are left to the private parties.

The PPP objectives result in a shift of content in the contract. Normally, a traditional public contract is based on demands and concrete descriptions. To fulfil the objectives, the PPP contract focuses on needs and functions, and it must be built on trust, transparency by open books, and co-operation between the parties.

Since the private party is responsible for the funding, design, completion, implementation, service and maintenance,<sup>562</sup> the incentive to build to reduce the cost of service and maintenance in the long run is changed. Thus, the PPP concept provides the contractor with a compelling reason to create the cheapest building or infrastructure for a period of 20 to 30 years.

In contrast to a traditional public contract, it is the contractor who has the obligation to provide services and operations. The PPP contract must run for a period equal to the time it takes for the private party to regain the investment. This is the main reason behind the long duration in PPP projects.

As mentioned above, some legal challenges occur in regard to PPP. One is the lack of legal definition, as analysed in subsection 3 below; another is the ban on negotiation, as analysed in subsection 4 below.

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<sup>561</sup> See also M. Burnett, *Public-Private-Partnerships (PPP) – a Decision Maker's Guide* (Maastricht: Institut Européen d'Administration Publique, 2008).

<sup>562</sup> See Commission (EC), 'Green Paper on public-private partnerships and Community Law on Public Contracts and Concessions' (Green Paper), COM (2004) 327 final, 30<sup>th</sup> April 2004.

### 3. The lack of a legal definition

EU law, the WTO and Chinese law have not considered the need of a legal definition of PPP.<sup>563</sup> All three legal systems lack a legal definition of PPP.

The WTO and the GPA<sup>564</sup> are based on the legal principles of transparency and non-discrimination principles.<sup>565</sup> The GPA is a plurilateral treaty including the WTO Members that are Parties to the GPA and thus have rights and obligations under the Agreement,<sup>566</sup> including public procurement rules. Also, the GPA enforces rules guaranteeing fair and non-discriminatory conditions for international competition.<sup>567</sup>

The EU procurement law is based on the common market and the elimination of barriers to trade in goods between Member States and barriers to movement in business, labour and capital. The political and economic reasoning behind the common market is based on the economic theory of comparative advantages.<sup>568</sup>

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<sup>563</sup> The same problem occurs in UNCITRAL.

<sup>564</sup> As analysed in chapter 4, the Agreement on Government Procurement (GPA) is to date the only legally binding agreement in the WTO focusing on the subject of government procurement. The WTO Agreement on Government Procurement (GPA) from the 4<sup>th</sup> of October 2006 establishes a set of rules which, on the one hand, govern the procurement activities of its Parties, and, on the other hand, enable the Agreement to function as an international one. The GPA is a plurilateral treaty administered by a Committee on Government Procurement, which includes the WTO Members that are Parties to the GPA, and thus have rights and obligations under the Agreement.

<sup>565</sup> Article III of the GPA.

<sup>566</sup> Government procurement is an important aspect of international trade, given the considerable size of the procurement market (often 10 to 15 percent of GDP) and the benefits for domestic and foreign stakeholders in terms of increased competition. Many WTO Members use their purchasing decisions to achieve domestic policy goals, such as the promotion of specific local industry sectors or social groups. Open, transparent and non-discriminatory procurement is generally considered to be the best tool to achieve 'value for money', as it optimises competition among suppliers.

<sup>567</sup> For example, governments will be required to put in place domestic procedures by which aggrieved private bidders can challenge procurement decisions and obtain redress in the event such decisions were made inconsistently with the rules of the agreement.

<sup>568</sup> See P. Krugmann and M. Obstfeld, *International Economics, Theory and Policy* (6<sup>th</sup> ed., London: Addison-Wesley, 2003), part I.

The purpose of the EU Procurement law is to ensure opening up of the public procurement market, not to promote PPP.<sup>569</sup>

The EU Treaty and the procurement directives set out principles, rules and procedures which must be followed before awarding a contract when its value exceeds set thresholds. The EU rules do not lay down any specific rules only applying to PPP.<sup>570</sup>

### 3.1. The EU public procurement objectives

There are many positive elements to the EU procurement rules. One is the possibility to eliminate a corrupt governmental practice; another is that effective public procurement is essential for good public services and good government.

The procurement rules ensure that the government applies the highest professional standards when it spends money on behalf of taxpayers. This procedure helps to ensure competition as the cornerstone of public sector procurement, and to maintain market interest – particularly where a well-established and competitive market does not already exist.

In markets with limited or no competition, the procurement rules can undertake market soundings; be prepared to adapt the requirements to the capacity and capabilities of the marketplace; and advertise and market contracting opportunities as broadly as possible.

The objectives of the specific EU public procurement directives are to ensure fairness and equal treatment; better procurement practices; open up the competition; and lower the overall prices. The basic principles to obtain these goals are transparency, non-discrimination, equal treatment, proportionality and competition.

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<sup>569</sup> S. Arrowsmith, *The Law of Public and Utilities Procurement*, (2<sup>nd</sup> edn., London: Sweet & Maxwell, 2005), p. 121. See also S. Arrowsmith, 'Public Private Partnerships and the European Procurement Rules: EU Policies in Conflict?' (2000) 37 *Common Market Law Review* 709-737, p. 709; and S. Arrowsmith, *The Law of Public and Utilities Procurement* (2<sup>nd</sup> edn., London: Sweet & Maxwell, 2005); M. Burnett, *Public-Private-Partnerships (PPP) – A Decision Maker's Guide* (Maastricht: Institut Européen d'Administration Publique, 2008); S. E. Hjelmberg, P. S. Jakobsen and S. T. Poulsen, *Public procurement law – the EU Directive on public contracts* (Copenhagen: Djøf, 2006); R. Nielsen, *Udbud af offentlige kontrakter* (Copenhagen: Jurist- og Økonomforbundets Forlag, 2005).

<sup>570</sup> C. H. Bovis, *EU Public Procurement Law* (Cheltenham: Elgar European Law, 2007), p. 52.

All these public procurement rules cover PPP, and, for this reason, the PPP has its difficulties.<sup>571</sup> A PPP must of course adhere to the principles and objectives of the public procurement rules, but it must also be based on some additional principles that ensures the specific characteristics of the PPP. This will require a legal PPP definition, which does not exist today.

### 3.2 A legal definition of PPP in the EU

In COM (2004) 327<sup>572</sup> the Commission states that ‘PPP is not defined at Community level’. The reason for this lack of a definition is to be found in the legal tradition. If the Commission instead sets up a legal definition of PPP, it would allow a long list of projects that would not be covered by this definition and the EU public procurement rules.

Instead of a legal definition, the Commission explains PPP in general as:

... forms of co-operation between public authorities and the world of business which aim to ensure funding, construction, renovation, management or maintenance of an infrastructure or the provision of a service.<sup>573</sup>

The Commission makes it clear<sup>574</sup> that PPPs in general qualify as a ‘public contract’ under Directive 2004/18.<sup>575</sup> The procedure for the

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<sup>571</sup> See S. Arrowsmith, ‘Public Private Partnerships and the European Procurement Rules: EU Policies in Conflict?’ (2000) 37 *Common Market Law Review* 709-737. In this article, Sue Arrowsmith argues that there are many difficulties in relation to PPP and the EU procurement rules.

<sup>572</sup> Commission (EC), ‘Green Paper on public-private partnerships and Community Law on Public Contracts and Concessions’ (Green Paper), COM (2004) 327 final, 30<sup>th</sup> April 2004.

<sup>573</sup> Commission (EC), ‘Green Paper on public-private partnerships and Community Law on Public Contracts and Concessions’ (Green Paper), COM (2004) 327 final, 30<sup>th</sup> April 2004, subsection 1.1.1.

<sup>574</sup> Commission (EC), ‘Communication on Public-Private Partnerships and Community Law on Public Procurement and Concessions’ (Communication) COM (2005) 569 final, 15<sup>th</sup> November 2005, on Public-Private Partnerships and Community Law on Public Procurement and Concessions.

<sup>575</sup> Council Directive (EC) 2004/18 on the co-ordination of procedures for the award of public works contracts, public supply contracts and public service contracts [2004] OJ L134/114, as amended.



award of the PPP must comply with the detailed provisions of the Directive, while also abiding by the rules and principles of the EU Treaty: the free movement rules, and the principles of transparency, equal treatment, proportionality and mutual recognition.<sup>576</sup>

By using this specific legal method, the Commission ensures the use of the EU procurement rules in a large amount of PPPs. The European Commission identifies two types of PPP used in the Member States: Public Private Partnerships of a purely contractual nature;<sup>577</sup> and Public Private Partnerships of an Institutional nature, in which the public and private parties establish a joint public limited company.<sup>578</sup>

In accordance with COM 2004/327, several Member States indicated that there was a need for a common set of EU rules on PPPs. The European Commission has participated in the discussion, but it does not agree that the lack of specific rules is a problem. The result of the Green Paper,<sup>579</sup> however, demonstrated a need in the Member States for clarification on the use of PPP under the EU public

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<sup>576</sup> If the situation is that EU procurement rules are an advantage for PPPs, then the Commission's decision not to provide a definition can be a sound idea legally. Hence, many PPPs will be governed by the procurement rules and principles in the EU treaty, the procurement Directives and the relevant case-law. If, on the other hand, the procurement rules are a disadvantage for PPPs, the lack of definition can have negative implications because it may result in reduced use of PPPs in general. The reason for a low number of PPP is because the transaction costs are too high; this is caused by the high amount of uncertainty.

<sup>577</sup> In some situations a PPP has been, and probably will be, set up as a concession. If the PPP can be legally defined as a concession, there are only few provisions of secondary legislation to coordinate this type of PPP. These provisions are Article 3(1) of Council Directive (EC) 93/37 concerning the co-ordination of procedures for the award of public works contracts [1993] OJ L199/54; and Articles 56 to 59 in Council Directive (EC) 2004/18 on the co-ordination of procedures for the award of public works contracts, public supply contracts and public service contracts [2004] OJ L134/114. See also C. H. Bovis, *EU Public Procurement Law* (Cheltenham: Elgar European Law, 2007), pp. 53-54.

<sup>578</sup> See also C. H. Bovis, *EU Public Procurement Law* (Cheltenham: Elgar European Law, 2007), p. 52. In accordance with Commission (EC), 'Green Paper on public-private partnerships and Community Law on Public Contracts and Concessions' (Green Paper), COM (2004) 327 final, 30<sup>th</sup> April 2004, PPPs of a purely contractual nature are, in general, the most common PPP solution in most Member States.

<sup>579</sup> See Commission (EC), 'Green Paper on public-private partnerships and Community Law on Public Contracts and Concessions' (Green Paper), COM (2004) 327 final, 30<sup>th</sup> April 2004..

procurement rules.<sup>580</sup> Nevertheless, in COM (2005) 569 the Commission did not consider this necessary and has subsequently made several announcements regarding the interpretation of Public Private Partnerships. Hence, the Commission is not at this time planning to create any legislative PPP rules.

The Commission stated in COM (2005) 569 that a non-binding initiative would provide the required guidance to address the perceived uncertainties with regards to institutionalised PPPs (IPPPs). The lack of a legal definition of an IPPP at Community level was most recently addressed in C (2007) 6661 and the Memo/08/95 of 18<sup>th</sup> February 2008.<sup>581</sup>

The Commission has published an interpretative communication C (2007) 6661<sup>582</sup> that, according to the Commission, will clarify ‘the rule of the game’ in relation to IPPPs, but not to PPP in general. The difference between an IPPP and a PPP is basically the formation of a joint company in an IPPP versus a purely contractual arrangement in a PPP.<sup>583</sup>

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<sup>580</sup> In addition, the European Parliament asked for some guidelines and relevant clarifications in connection with the award of IPPP. Parliament (EU), Resolution on public-private partnerships and Community law on public procurement and concessions (2006/2043(INI)), 26 October 2006.

<sup>581</sup> A legal definition of IPPP and specific rules concerning IPPPs are not to be found at Community level; see the Commission (EC), ‘Interpretative Communication on the Application of Community Law on Public Procurement and Concessions to Institutionalised Public-Private Partnerships (PPP)’ (Communication) C (2007) 6661, 5<sup>th</sup> February 2008; cf. Commission (EC), ‘Communication on Public-Private Partnerships and Community Law on Public Procurement and Concessions’ (Communication) COM (2005) 569 final, 15<sup>th</sup> November 2005, section 4.1., in which the Commission stated that an Interpretative Communication would be the best way to encourage competition and to provide legal certainty. The Commission stated in COM(2005)569 that a non-binding initiative would provide the required guidance to address perceived uncertainties in regard to IPPPs. The lack of legal definition of an IPPP at Community level is addressed again in C (2007) 6661 and Commission (EC), ‘Public Procurement: Commission issues guidance on setting up Institutionalised Public-Private Partnerships – Frequently Asked Questions’ (Memo) MEMO/08/95, 18<sup>th</sup> February 2008.. See also Parliament (EU), Resolution on public-private partnerships and Community law on public procurement and concessions (2006/2043(INI)), 26 October 2006.

<sup>582</sup> Commission (EC), ‘Interpretative Communication on the Application of Community Law on Public Procurement and Concessions to Institutionalised Public-Private Partnerships (PPP)’ (Communication) C (2007) 6661, 5<sup>th</sup> February 2008

<sup>583</sup> See Chapter 2 above for the definitions of PPP and IPPP.

The Commission concludes that the aim of the interpretative communication was to enhance legal certainty and alleviate the concerns that procurement rules and EU law in general would make IPPPs unattractive or impossible to carry out.<sup>584</sup>

The perceived lack of legal certainty in the Member States in relation to the involvement of private partners, and the risk of the IPPP being non-compliant with EU Law, were the reasons for publishing the IPPP interpretation communication C (2007) 6661.<sup>585</sup>

The same lack of legal certainty can be claimed in regard to PPP. The Committee of the Regions states that given the lack of definition of PPP, the fact that adequate legislation is not yet in place, and the lack of experience in the Member States, mostly the new Member States, there is a need for an interpretative communication covering all forms of PPP agreements. Thus, the Committee asks for a communication covering more than the aim of COM (2007) 6661, which only covers the IPPP.<sup>586</sup>

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<sup>584</sup> R. William, 'The Commission Interpretative Communication on the Application of Community Law on Public Procurement and Concessions to Institutionalised Public Private Partnerships (IPPPs)' (2008) 17 (4) *Public Procurement Law Review* NA116.

<sup>585</sup> This legal uncertainty and risk can discourage both public authorities and private parties from entering into an IPPP. This risk is a problem since public authorities at all levels are interested in types of co-operations with the private sector, and this interest is increasing in the Member States. The interest in forming IPPPs is increasing because of national needs for ensuring infrastructure and services; see Commission (EC), 'Public Procurement: Commission issues guidance on setting up Institutionalised Public-Private Partnerships – Frequently Asked Questions' (Memo) MEMO/08/95, 18<sup>th</sup> February 2008.. The IPPP interpretation communication therefore sets out the Commission's understanding of how the Community provisions on most types of public procurement and concessions are to be applied to the funding and operation of an IPPP as a legal guidance to the Member States. The interpretation communication does not create new rules concerning IPPPs; it only reflects the Commission's understanding of the rules in the procurement Directive and the EU treaty, and the relevant case law by the ECJ.

<sup>586</sup> The European Parliament in Parliament (EU), Resolution on public-private partnerships and Community law on public procurement and concessions (2006/2043(INI)), 26 October 2006., see *General comments, no.2*, considers it premature to assess the effects of the public procurement directives and is, therefore, against a review of these directives. It also opposes the creation of a separate legal regime for PPPs but considers that there is a need for legislative initiatives in the areas of concessions, respecting the principles of the internal market and threshold values, providing simple rules for tendering procedures, and for clarification with regards to institutionalised public-private partnerships (IPPPs).

One objective in providing this interpretative communication would be to ensure legal certainty in regard to IPPP; another would be to open up to a more efficient use of PPP. In relation to PPP there is a need of both legal certainty and rules that ensure more efficiency, which is discussed right below.

#### 4. The economics terms of PPP

As mentioned above in chapter two, PPP was invented in the 1990s as a new method of public service and works delivery in order to improve the value for money, and as a potential method of bringing private finance to the public sector.<sup>587</sup> In the mid 1990s, many governments experienced pressure of fiscal deficits and an increasing public debt burden.<sup>588</sup> At the same time the governments were facing a pressure to expand and improve public facilities and services.<sup>589</sup> PPP was invented as a tool to implement EU policies and aims to fill the gap between the public needs and the need of financing.<sup>590</sup>

The idea behind the PPP can be found in the private market contract arrangement as a result of globalisation. The private market already had experience in using strategic alliances to increase quality and decrease the cost, and, therefore, increase the value for money. The motivation for making a strategic alliance was, and still is, to make a business arrangement that creates dynamism, collaboration, and mutual learning among the parties. Therefore, initial agreements

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<sup>587</sup> The United Kingdom and Australia were the first countries in OECD to set up this mode of service delivery. Now France, Germany, Ireland, Italy, Japan, Portugal, Spain, Turkey, Argentina, Brazil, South Africa, Poland, Denmark, Portugal, Hungary, Netherlands, and several other countries have introduced PPP. See OECD, *Public-Private Partnerships, in pursuit of risk sharing and value for money* (Paris: OECD, 2008), p. 11; and D. Grimsey and M. Lewis, *Public-Private Partnerships, The worldwide Revolution in infrastructure provision and project finance* (Cheltenham: Elgar, 2007), pp. 3-5.

<sup>588</sup> See OECD, *Public-Private Partnerships, in pursuit of risk sharing and value for money* (Paris: OECD, 2008), p. 11.

<sup>589</sup> D. Grimsey and M. Lewis, *Public-Private Partnerships, The worldwide Revolution in infrastructure provision and project finance* (Cheltenham: Elgar, 2007), p. 19.

<sup>590</sup> M. Burnett, *Public-Private-Partnerships (PPP) – A Decision Maker's Guide* (Maastricht: Institut Européen d'Administration Publique, 2008)p. 1.

have less to do with success than adaptability to changes in the market and in consumer needs.<sup>591</sup>

The private sector met the consumer demand with new types of contracts including collaboration. The PPP contract used today in many EU Member States aims to fulfil this need.<sup>592</sup> The governmental attention to market mechanisms and the success of privatisation efforts in several countries increased the interest in PPP.<sup>593</sup>

PPPs have received a boost in various countries undergoing a process of significant economic growth. By using PPP, it is possible to provide additional capital; to set up alternative management procedures and implementation skills; to provide value added to the consumer and the public at large; and to provide better identification of needs and optimal use of resources.<sup>594</sup>

The market for PPP, and co-operation between the public and private sectors for the development and operation of infrastructure for a wide range of economic activities, has increased. Years ago, PPP arrangements were often driven by limitations in public funds to cover investment needs. Today, PPP is also driven by interest in increasing the quality and efficiency of public services in infrastructure projects, e.g. in sectors such as technology, water, prisons, welfare, transport, public health, schools, urban regeneration, and national security<sup>595</sup> and providing a wide range of public services, like telecommunication, plants, financial support, innovative financing, general public services, education, and research.

A PPP must deliver infrastructures, buildings and services from a value for money perspective. This means that a significant part of establishing a PPP arrangement is that the output will be better than a

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<sup>591</sup> Y. L. Dos and G. Hamel, *Alliance Advantage, The art of creating value through Partnering* (Boston, Massachusetts: Harvard Business School Press, 1998), Introduction p. 15.

<sup>592</sup> C. D. Tvarnø, 'Public private partnership in the European Union', in R. Nielsen and S. Treumer (eds.), *The New EU Public Procurement Directives* (Copenhagen: Djøf, 2005), pp. 183-194.

<sup>593</sup> N. Pongsiri, 'Regulation and public private partnership' (2002) 15(6) *International Journal of Public Sector Management* 487-495, pp. 487-495.

<sup>594</sup> See Commission (EC), 'Guidelines for Successful Public Private Partnerships' March 2003, p. 4.

<sup>595</sup> D. Grimsey and M. Lewis, *Public-Private Partnerships, The worldwide Revolution in infrastructure provision and project finance* (Cheltenham: Elgar, 2007), pp. 8-10.

similar traditional public project.<sup>596</sup> Value for money means: reducing the cost and price; increasing the quality; reducing the risks and failures; improving the co-ordination; and sharing responsibility and capacity. Those objectives result in a shift of content in the contract.

The PPPs can achieve additional value compared with other approaches if there is an effective implementation structure, and if the objectives of all parties can be met within the partnership between the public and the private parties.

In a world of imperfect and incomplete contracts, it is still possible to gain some significant values from a properly structured PPP project.<sup>597</sup> The benefits or advantages of setting up a well functioning PPP are:<sup>598</sup>

- Acceleration of infrastructure provision;
- Faster implementation;
- Reduced whole life costs;
- More optimal risk allocation;
- Improvement of the incentives to perform;
- Improve the quality of service;
- Generation of additional revenues in the private sectors;
- Transferring responsibility;
- Enhanced public management;
- Increasing investments in general;
- Higher efficiency in the use of resources by joint utilities;
- Generating commercial value from public sector assets by joint utilities.

In the end, all these factors can fulfill the main scope of a PPP agreement, which is to ensure joint utility between the parties, thereby ensuring the most efficient product at the lowest price.

The first priority is to achieve the goal of common utility. The common utility can be explained by this following example, an

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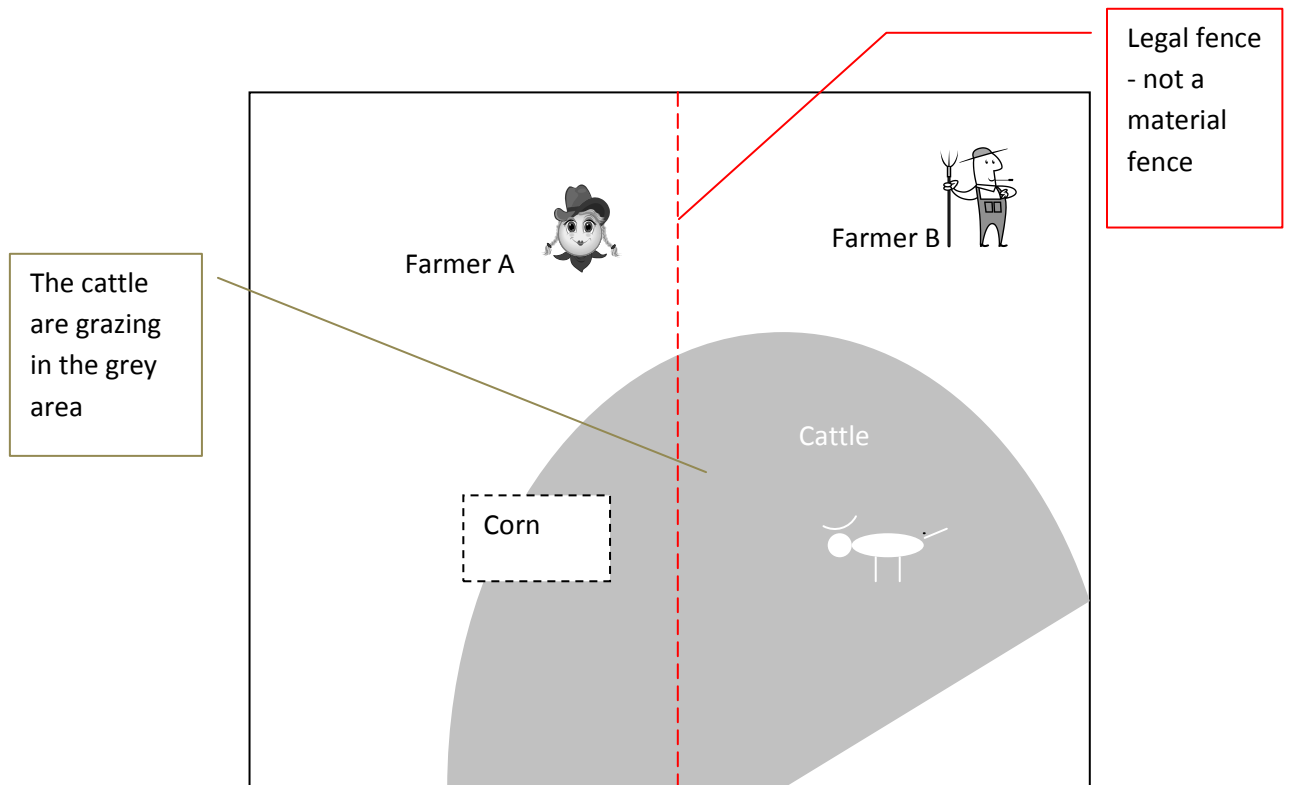
<sup>596</sup> OECD, *Public-Private Partnerships, in pursuit of risk sharing and value for money* (Paris: OECD, 2008), p. 36.

<sup>597</sup> See also D. Grimsey and M. Lewis, *Public-Private Partnerships, The worldwide Revolution in infrastructure provision and project finance* (Cheltenham: Elgar, 2007), p. 247.

<sup>598</sup> See also OECD, *Public-Private Partnerships, in pursuit of risk sharing and value for money* (Paris: OECD, 2008), p. 37 and Commission (EC), 'Guidelines for Successful Public Private Partnerships' March 2003, pp. 15-16.

example using applied economics and not evolving economic theory:<sup>599</sup>

Farmer A lives next to farmer B. Farmer A grows corn on some of her land and leaves some of the land uncultivated. Farmer B runs cattle on all his land.



Source: C. Tvarnø based on R. Cooter and T. Ulen, *Law and Economics*, (5th edn., London: Addison-Wesley, 2008), p. 88.<sup>600</sup>

There is no fence between the two ranches, but the boundary is clear. Thus, from time to time farmer B's cattle wander into farmer A's property and damage farmer A's corn.

<sup>599</sup> The application of this economic example does not include all conditions and presumptions in the Coase Theorem.

<sup>600</sup> In regard to definitions, conditions and presumptions in the Coase Theorem look further in R. Cooter and T. Ulen, *Law and Economics*, (5th edn., London: Addison-Wesley, 2008).

From a legal point of view, farmer B would then have to pay farmer A for the damage to the corn. With regards to future damage, farmer B must build a fence around his land to keep the cattle inside his own property and, by that measure, ensure that future damage will not occur.

If instead the two farmers, in a world without transaction cost, used another approach than the traditional legal solution, one could imagine a solution where the two farmers fell in love and got married. Such a decision would imply that the farmers combined their business interests, and, therefore, their joint profits. The joint profit would then be highest if they were to build a small fence around the cornfield. This would be the best value for money in this specific situation and the optimal joint solution.<sup>601</sup> If the farmers did not fall in love but were just neighbours deciding to negotiate the best value for money, in a world without transaction cost, the two farmers still could end up with a more efficient solution than the legal solution if they negotiated. This idea of negotiation is fundamental in relation to optimal contracts in, for example, strategic alliances,<sup>602</sup> partnering contracts, and PPP.

As stated above, more value for money requires that the parties negotiate and co-operate with joint utility as their focus. The purpose of the PPP contract is, by using the idea of joint utility, to:

- Reduce the cost and price
- Increase the quality
- Reduce the risk
- Reduce the failures
- Improve the co-ordination
- Share capacity with the private party

The important role of the economic operator participates at different stages in the project (design, completion, implementation, funding). The public partner concentrates primarily on defining the objectives to be attained in terms of public interest, the quality of services provided,

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<sup>601</sup> See further R. Cooter and T. Ulen, *Law and Economics*, (5th edn., London: Addison-Wesley, 2008), p. 88.

<sup>602</sup> See, for example, I. Macneil, *The New Social Contract* (New Haven, CT: Yale University Press, 1980); and K. W. Artz and T. H. Bruch, 'Asset specificity, uncertainty and relational norms' (2000) 41 *Journal of Economic Behavior & Organization* 337-362.



and the pricing policy, and it takes responsibility for monitoring compliance with these objectives.

The distribution of risks between the public partner and the private partner is different. The risks generally borne by the public sector are transferred to the private party if this is efficient with regards to the transaction and the project.<sup>603</sup> A well-functioning PPP is highly reliant on the ability of the parties to set up the incentive structure in the right way. One part of a workable incentive scheme is when the supplier bears the right amount of risks, on the grounds that those with money at stake have an incentive to make the efficient decision.<sup>604</sup>

The parties are the best placed to negotiate the risk and the value of this risk. If the public party in the tender notice already sets up the distribution of the risk as demanded by the public procurement law, the project cannot create the best value for money.

#### **4.1 Co-operation as a key element in PPP**

The lack of a legal definition of PPP is a serious problem because EU law does not consider co-operation and negotiation as key elements to a successful PPP.

Both parties must have influence on the PPP project. However, the public procurement rules request that the public party sets up the conditions to the contract and the co-operation almost single-handedly. Only very minor matters can be changed after the award, otherwise a new procedure must be set up.

The competitive dialogue sets up a procedure in which a certain amount of dialogue becomes possible. It is not the aim of this chapter to discuss this procedure. A single remark related to the competitive dialogue is that it does not open up for a negotiation between the parties in the PPP but instead for a dialogue between all parties, which is an altogether different matter.

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<sup>603</sup> The Commission notes that a PPP does not necessarily entail that the private partner assumes all the risks, or even the major share of the risks linked to the project. The precise distribution of risk is determined case by case, according to the respective ability of the parties concerned to assess, control and cope with this risk.

<sup>604</sup> See also D. Grimsey and M. Lewis, *Public-Private Partnerships, The worldwide Revolution in infrastructure provision and project finance* (Cheltenham: Elgar, 2007), p. 247.

The EU public procurement rules in general do not promote and support the idea of co-operation. The Commission believes that the existing public procurement rules can accommodate all new ideas and needs, to create new types of co-operation between public and private parties, and to cover all situations created by the market.

However, the Commission does not take in consideration that PPPs have very specific characteristics with regard to the co-operation and output that are not reflected in the EU public procurement rules. The lack of acknowledgement of the need for co-operation and negotiation between the parties is troublesome.

The main priority of the present legislation is equal treatment, transparency, and free movement, all fundamental principles in the European Union. But the citizens, the private parties, and the public authorities must also be given the possibility to achieve the most efficient agreement and outcome of a PPP.

Hence, the principles of the procurement rules are to ensure competition, equal treatment, and transparency, but not co-operation. Instead, there is a general legal ban on negotiation, which will be discussed below in subsection 4.

## **4.2 Solutions to an efficient PPP**

The aim of specific PPP rules must be to enhance legal certainty and alleviate concerns that traditional procurement rules might make PPPs unattractive or impossible to carry out. With regards to the legal uncertainty, there are two approaches,

One approach is that existing public procurement rules and principles cover all PPPs, rendering a definition of PPP unnecessary. This is the natural legal solution. The existing rules cover all new ideas, all needs to create new types of co-operation between public and private parties, and all situations created by the market. However, this traditional legal solution does not take into consideration that a PPP has very specific characteristics with regard to the co-operation and output needed to create an efficient PPP.

Another approach is to let the public authorities use the option of co-operating with private parties under conditions similar to market conditions. This solution is in conflict with the procurement procedure in general.

A simple solution is to set up specific PPP rules in the public procurement regulation and legally define exactly what a PPP is; how

a PPP has to be set up; how to ensure a fair and transparent competition when selecting the private parties; and how to run a PPP. When this is accomplished, the PPP can use a different set of procurement rules which acknowledge the special aim of the PPP; the public service operate in market conditions with the benefits related to the market; and co-operation can be prioritised.

It should be emphasised that the aim and purpose of the EU public procurement law is generally good, but not when there is a particular need or market for new types of co-operation between public and private parties. While also subject to special procedural rules, the PPP rules should allow the special turnaround in the traditional incentive procurement structures necessary for PPP. PPP has the intention of achieving greater economic efficiency by changing the incentive structure of co-operation.

Thus, since the EU public procurement law does not specify concrete PPP rules and definitions, barriers to the use of PPP as an alternative and more efficient procurement model can be a serious reality.

The lack of rules and definitions might create barriers that increase the transaction costs in connection with the public procurement of PPP projects. PPP can provide a significant economic advantage, and beside the existing objectives regarding transparency and equal treatment, the EU public procurement rules should also address the economic efficiency of PPP.

At this point, the general development, and more than ten years worth of knowledge concerning PPP, should make it possible to introduce a specific definition of PPP into not only the current EU Public Procurement Directives, but also the WTO and the GPA. Specific PPP rules can help create a functioning PPP market with the economic benefits that a market can create; this is necessary in the EU and internationally.

### **4.3 A tight PPP definition**

Specific PPP rules could contain a *tight* definition stating which PPP arrangements are covered by these rules. Under such a definition, only PPP arrangements falling within the definition would be covered by the special PPP rules. If a PPP project is excluded from the definition in the specific PPP rules, the project would, instead, be subject to the general procurement rules and regulations. Thus, if the PPP falls

outside the scope of any definition of a PPP, the traditional public procurement rules will apply to the set-up. Only when a strict definition of a PPP is fulfilled, should the specific PPP rules apply to the PPP.

On the one hand, the Commission is correct in stating that the traditional procurement rules and principles can handle the formation of a PPP. On the other hand, the Commission still ought to consider specific PPP rules at community level in order to allow the best and most effective outcome of the PPPs, including a precise and tight legal definition of the PPP. If a public project falls inside a tight and legally binding PPP definition, a more efficient output of the transaction can be possible compared to traditional public projects.

## **5. The problem with the ban on negotiation**

A PPP is a collaborative contract and should, as such, be based on a high degree of negotiation between the parties. The principles surrounding a PPP contract are trust, cooperation, open books, joint utility, and positive incentives. These factors are agreed upon between the parties - the building owner, the architect, the engineer and the constructor. Some degree of negotiation in collaborative contracts is an important tool for obtaining the objective of the contract, which is better and cheaper results.

In general, public procurement law does not lay down any special rules covering the different types of collaborative PPP contracts, and the question must be how can a contract based on negotiation, cooperation, trust, openness and common utility be possible within the public procurement law?

When for example a public authority in the EU entrusts the provision of an economic activity to a private party, the EC internal market rules and principles must be followed. The general legal principles derived from the treaty are: transparency, equality, proportionality and mutual recognition. The public procurement law sets out a long list of rules in the public procurement directives. The principle of the ban on negotiation can be derived from the directives.

Collaborative contracts, such as the different types of PPPs mentioned in chapter two above, require negotiation and co-operation to work. Otherwise it is difficult, if not impossible, to gain better value and lower cost. The ban on negotiation prevents this gain.

Public procurement law protects some main objectives:

- An open market
- Competition
- Equal treatment
- Elimination of corruption
- Transparency
- Non-discrimination
- Proportionality
- Effective public procurement
- Application of the highest professional standards
- Maintaining market interest
- Increasing prices

The positive experience seen in the private sector regarding collaborative contract arrangement<sup>605</sup> (e.g. the creation of dynamism, new incentives, co-operation, risk diversity, efficient use of core competencies, and mutual learning among the parties) cannot be created in regard to PPP under the procurement rules because of the objectives and idea behind the ban on negotiation.

Neither the WTO nor the EU gives room for using negotiation, nor do they set up a procedure that allows negotiation in regard to traditional works or service projects. The competitive dialogue sets up a procedure that allows the public party to discuss the same question with all tenderers at the same conditions. But this is not the same as negotiation.<sup>606</sup>

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<sup>605</sup> When private parties set up a strategic alliance, they negotiate the contract. A strategic alliance contract between private parties could, for example, be implemented as the well-known partnering contract used in connection with strategic alliances and in the building industry. This contract is also based on trust, co-operation, and negotiation between the parties, and is used when the need for co-operation is distinct; see further: A. Deering and A. Murphy, *The Difference Engine: Achieving Powerful and Sustainable Partnering* (Aldershot: Gower, 1998); J. Barlow, M. Cohen, A. Jasphapara and Y. Simpson, *Towards Positive Partnering: Revealing the Realities in the Construction Industry* (Bristol: The Policy Press, 1997); and Y. L. Dos and G. Hamel, *Alliance Advantage, The art of creating value through Partnering* (Boston, Massachusetts: Harvard Business School Press, 1998).

<sup>606</sup> According to the Commission, the competitive dialogue will provide the necessary flexibility in the discussions with the tenderers on all aspects of the PPP

## 5.1 PPP, negotiation and game theory

The optimal PPP is dependent on negotiation and a well-functioning interrelationship between the parties. The interrelationship depends on both the task, and the contract regarding the project.

Regardless of the contract type, economic theory considers contracts as (Pareto) optimal if the following conditions are in place. Given a set of alternative allocations of goods or outcomes for a set of individuals, a change from one allocation to another that can make at least one individual better off without making any other individual worse off, is called a 'Pareto improvement'. An allocation is defined as 'Pareto efficient' or 'Pareto optimal' when no further Pareto improvements can be made.<sup>607</sup>

Game theory can be used to argue that

“for individuals pursuing their own self-interest, incentives for co-operation will be greater than for selfish behavior ... under a wide variety of circumstances, including when the “partners” are hostile”.<sup>608</sup>

Within game theory, the prisoner's dilemma can explain the problems between common utility and negotiation. In 1950, Albert W. Tucker defined a fundamental problem in the game theory, showing that two persons choose not to co-operate even though they both can see the common interest in collaborating.<sup>609</sup> Game Theory and the prisoner's

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contract during the set-up phase. At the same time, this procedure will ensure that the dialogue is conducted in compliance with the principles of transparency and equality of treatment, and the EC Treaty principles.

<sup>606</sup> See also Commission (EC), 'Green Paper on public-private partnerships and Community Law on Public Contracts and Concessions' (Green Paper), COM (2004) 327 final, 30<sup>th</sup> April 2004.section 25.

<sup>607</sup> Steven Shavell, 'Contracts', in P. Newman (ed.), *The New Palgrave Dictionary of Economics and the Law* (Basingstoke: Palgrave Macmillan, 1998), p. 436.

<sup>608</sup> R. W. McQuaid, 'The theory of partnerships: why have partnership?', in S. P. Osborne (ed), *Public-Private Partnerships: Theory and Practice in International Perspective* (London: Routledge, 2000), p. 27.

<sup>609</sup> See A. Rapoport, 'Prisoners' Dilemma and Game Theory', in P. Newman (ed.), *The New Palgrave Dictionary of Economics and the Law* (Basingstoke: Palgrave Macmillan, 1998), p. 100.

dilemma can be explained by this following example, an example using applied economics and not involving economic theory.<sup>610</sup>

Two people have been arrested in possession of some stolen goods. The prosecutor has enough evidence to have them prosecuted and convicted for possession of stolen goods, unless one or both of them confess to burglary. If the prosecutor only prosecutes the persons for being in possession of stolen property, it will lead to a lower penalty than the burglaries. The two people, now known as the prisoners, are put in isolation and therefore cannot talk to each other.

Each prisoner is visited by the prosecutor, and each gets the same deal. If the prisoner confesses and by that also gives evidence about the other prisoner, he himself will go free while the other receives the maximum sentence of four years. If both prisoners confess, they will each get two years in prison for burglary. If neither confesses, each prisoner will get a half year in prison for possession of stolen goods because the break-in cannot be proved.

The prisoner's dilemma can also be described as follows:<sup>611</sup>

		Prisoner 2	
		Not confess	confess
Prisoner 1	Not confess	$-\frac{1}{2}, -\frac{1}{2}$	-4,0
	confess	0, -4	-2, -2

<sup>610</sup> The application of this economic example does not include all conditions and presumptions in the prisoner's dilemma game and the game theory.

<sup>611</sup> R. Cooter and T. Ulen, *Law and Economics*, (5th edn., London: Addison-Wesley, 2008), p. 38-40.

‘Confession’ is the dominant strategy because ‘confession’ is the optimal choice for each player, regardless of what the other player does. Prisoners 1 and 2 are in the same situation and have the same information. Thus, the game ends by both payers spending two years in prison instead of only half a year.<sup>612</sup>

The prisoner's dilemma can be seen as an illustration of the difference between individual and collective rationality. Decisions that are rational from the individual's hand are bad when seen with common eyes, even though an outsider can see the rational gains from a common perspective.<sup>613</sup>

The objectives regarding PPP can be explained by the game theory. The collaborative contracts were introduced as an alternative to traditional construction contracts. The aim was to ensure that the parties would optimise the transaction instead of their own profit. Thus, the parties must optimise the joint utility and not only their own utility. To obtain this objective, the parties must share all information relevant to the project and work with open books and calculations. The relationship must be built on co-operation and trust.

If a PPP relationship is based on these economic factors, it is possible to move the output from the Nash equilibrium to the Pareto optimal situation in the matrix. But the parties need legal solutions to obtain this situation.

## 5.2 A contract law perspective

From a contractual point of view, it is a general rule in civil law and common law countries that parties have contractual freedom. The reason behind the freedom of contract is individual autonomy and public benefit. The contract is binding upon the parties and determines the rights and liabilities.<sup>614</sup>

The principle is a product of a liberalist belief that when the individual is free from historical constraints and authorities, the

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<sup>612</sup> R. Cooter and T. Ulen, *Law and Economics*, (5th edn., London: Addison-Wesley, 2008), p. 40.

<sup>613</sup> A. Rapoport, ‘Prisoners’ Dilemma and Game Theory’, in P. Newman (ed.), *The New Palgrave Dictionary of Economics and the Law* (Basingstoke: Palgrave Macmillan, 1998), p. 100.

<sup>614</sup> W. Flume, *The General Part of Civil Law, Vol. 2: The Transaction*, (4<sup>th</sup> edn., Berlin: Springer, 1992), p. 7



individual is capable of determining his acts and responsibilities, and thereby the person can decide whether or not to make a contract.<sup>615</sup>

### 5.2.1 The basic clauses in a well-functioning PPP

The basis of PPP contracts is to create more value for money, and a well-functioning PPP contract should implement the following contract elements:<sup>616</sup>

<b>Legally binding clauses</b>	<b>Process-based clauses</b>
The parties share all information. They have open books and accounts.	The parties optimise the transaction, which means they optimise joint utility and not their own utility.
At the beginning of the relationship, The parties do not know the final product. Instead, the parties' demands are in focus.	The relationship is built on co-operation and trust.
The parties share the responsibility and cost of failures.	The process is more important than the product because the process facilitates the creation of the best and most efficient product.

The Governments should<sup>617</sup> implement the above-mentioned elements into the PPP contract because it can result in a significant turn in the

<sup>615</sup> K. Zweigert and H. Kötz, *An introduction to comparative law* (3 edn., Oxford: Clarendon, 1998), p. 324.

<sup>616</sup> See also Christina D. Tvarnø, 'Law and Regulatory Aspects of Public-Private Partnerships: Contract Law and Public Procurement Law', in G. Hodge, A. Hodge, C. Greve and A. Boardman (eds.), *International Handbook On Public-Private Partnerships* (Cheltenham: Elgar, 2010), chapter 10.

<sup>617</sup> The public authority also will face a number of other challenges. See for this subject M. Burnett, *Public-Private-Partnerships (PPP) – A Decision Maker's Guide* (Maastricht: Institut Européen d'Administration Publique, 2008)p. 116.

incentives on a long term basis; a shift of focus to needs instead of demands; improvement of co-ordination; a better use of core competencies; shared capacity with the private party; an increase in quality; a reduction of risk and failures; shared risks; and a reduction in cost and price.<sup>618</sup>

The aim is that both the public and the private party benefit from such a contractual relationship if the performance is based on needs instead of demands. Thus, the contract should not state exactly what the private party must perform; rather, it should state which needs the end product must fulfil.

This can be ensured if the public party defines the needs and objectives of the public interest instead of the traditional definition of demands. It will then be up to the private party to create the design, completion, implementation, services, and funding, as these are all core competences of a private party.<sup>619</sup>

From a contractual point of view, a PPP can be set up as one single contract running until the investment has been returned, or as two separate contracts – one concerning the works agreement and one concerning the service, maintenance and operation agreement. In the long term, the private party runs the building or infrastructure, and the public party provides the typical public service – e.g. the learning and teaching in a school in regard to the PPP project.<sup>620</sup>

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<sup>618</sup> J. Barlow, M. Cohen, A. Jaspapara and Y. Simpson, *Towards Positive Partnering: Revealing the Realities in the Construction Industry* (Bristol: The Policy Press, 1997); Y. L. Dos and G. Hamel, *Alliance Advantage, The art of creating value through Partnering* (Boston, Massachusetts: Harvard Business School Press, 1998); and E. E. Scheuing, *The Power of Strategic Partnering* (Portland: Productivity Press, 1995).

<sup>619</sup> For further discussions and analyses of Danish PPP arrangements, see C. D. Tvarnø, 'Public-Private Partnerships from a Danish perspective' (2006) *Public Procurement Law Review* NA98; C. D. Tvarnø, *PPP and Public service Broadcasting* (Copenhagen: Julebog, 2005), pp. 181-201; C. D. Tvarnø, 'Public private partnership in the European Union', in R. Nielsen and S. Treumer (eds.), *The New EU Public Procurement Directives* (Copenhagen: Djøf, 2005), pp. 183-194.

<sup>620</sup> Great Britain was the first EU Member State to use partnering agreements. The British government uses partnering agreements to build schools, roads, office buildings etc, and has done so for more than ten years. See: [http://www.ogc.gov.uk/procurement\\_policy\\_and\\_application\\_of\\_eu\\_rules\\_uk\\_regulations.asp](http://www.ogc.gov.uk/procurement_policy_and_application_of_eu_rules_uk_regulations.asp) and <http://www.opsi.gov.uk/si/si2006/20060005.htm> accessed 30 November 2010; and: [http://www.hm-treasury.gov.uk/ppp\\_standardised\\_contracts.htm](http://www.hm-treasury.gov.uk/ppp_standardised_contracts.htm) accessed 30 November 2010; and other documentation on:

In regard to two private parties, this contractual freedom means that the parties can agree on what they want. To some extent, private law principles also covers public contracts. The legal regulation of public contracts usually adheres closely to the ordinary private law.<sup>621</sup> But when a public party contracts with private parties, the public procurement rules and principles must be followed when setting up the procurement procedure and choosing the private party.

Pursuant to Article 1(2)(a) in the EC Directive 2004/18/EC, public contracts are contracts for pecuniary interests, concluded in writing, between one or more economic operators and one or more contracting authorities, and having as their object the execution of works,<sup>622</sup> supply<sup>623</sup> and the provision of services.<sup>624,625</sup>

Thus, in accordance with the public procurement rules in the procurement Directive, or in the GPA, the public contracting authority in a PPP must choose the private contracting party by a tender procedure, and the contract must be concluded on the basis of the draft contract laid down in the tender documents without any scope for amendments and negotiations.<sup>626</sup>

On the one hand, public procurement law does not define the content of the contract, and the content of the PPP contract is not covered by the public procurement rules. But on the other hand, the parties cannot negotiate the terms of the contracts as freely as two private parties. The public procurement regulation and the tender procedures set restrictions on negotiations similar to private contracts.

These rules and principles mentioned above result in a contract situation where the public party must tender out the contract terms in such a way that all potential bidders can see the terms and bid on the same terms. This results in a situation where the public contract cannot take into account the evolution of a product or service over a longer duration period.

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<<http://www.4ps.gov.uk/PageContent.aspx?id=2&tp=Y&s=0&title=ppp&Type=1&searchbtn=Go&x=31&y=15&p=93>> accessed 30 November 2010; and:

<<http://www.4ps.gov.uk/PageContent.aspx?id=2&tp=Y&s=0&title=ppp&Type=1&searchbtn=Go&x=31&y=15&p=88>> accessed 30 November 2010.

<sup>621</sup> H Collins, *Regulating Contracts* (Oxford: Oxford University Press), p. 304.

<sup>622</sup> Article 1(2)(b) in Directive 2004/18/EC.

<sup>623</sup> Article 1(2)(c) in Directive 2004/18/EC.

<sup>624</sup> Article 1(2)(d) in Directive 2004/18/EC.

<sup>625</sup> See C. H. Bovis, *EU Public Procurement Law* (Cheltenham: Elgar European Law, 2007), p. 157.

<sup>626</sup> See S. E. Hjelmberg, P. S. Jakobsen and S. T. Poulsen, *Public procurement law – the EU Directive on public contracts* (Copenhagen: Djøf, 2006), p. 201.

### 5.3 PPP, negotiation and a legal policy perspective

Collaborative contracts were invented to address a need for new contract models. The public sector is keen on a new contract model, but cannot benefit from the PPP model due to the EU public procurement law and the ban on negotiation.

In order to gain the economic benefits from the collaborative contracts, the parties must have access to negotiation and co-operation under the EU public procurement law. On the contrary, the purpose of the WTO, EU and the Chinese public procurement law is to ensure a transparent, proportionally, competitive open market for public procurement.<sup>627</sup> These main objectives do not support the idea of negotiation and common utility, which is the main objective behind collaborative contracts.

Both the WTO and the EU must accept the fact that a PPP is an alternative to a traditional public transaction and this alternative cannot develop in the same legal environment as traditional public arrangements. The WTO and the EU must acknowledge the need of negotiation and collaboration. Both systems prevent negotiation and do not set up an alternative procedure in favour of more efficient PPP contracts.

The public procurement regulation and the tender procedures set out serious restrictions preventing negotiation and collaboration. A public contract cannot be negotiated by the parties in the same way as a private contract. The public procurement rules result in a contract situation where the public party must tender out the contract terms in such way that all potential bidders can see the terms and bid on the same terms.

PPP contracts can create better and cheaper buildings and services. 16 percent of the GDP in the EU is spent on public contracts, and the main rule is that the parties cannot negotiate. Thus, a public contract cannot achieve the benefit of negotiation as offered by a private contract. Public contracts, because of this restriction, tend to be incomplete by design in situations where the product is not typical

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<sup>627</sup> S. Arrowsmith, *The Law of Public and Utilities Procurement*, (2<sup>nd</sup> edn., London: Sweet & Maxwell, 2005), p. 121; C. H. Bovis, *EU Public Procurement Law* (Cheltenham: Elgar European Law, 2007), p. 52; and M. Burnett, *Public-Private-Partnerships (PPP) – A Decision Maker's Guide* (Maastricht: Institut Européen d'Administration Publique, 2008)

or easy to define.<sup>628</sup> In such situations, negotiation is extremely relevant.

However, the EC procurement rules must take into account the need of specific rules regarding collaborative contracts. Otherwise, the public sector will not receive the economic benefits arising from negotiation and collaboration.

#### **5.4 Proposal of a new PPP procedure**

One way to ensure a more efficient PPP transaction is to recognise the need for negotiation by setting up a new procedure allowing some degree of negotiation by acknowledging PPP as an alternative project type. This new procedure must be combined with the above proposed tight legal definition of a PPP arrangement. Only PPP arrangements falling under this tight legal definition can be allowed to use the PPP procedure for negotiation.

Another, and maybe more easy way, is to allow PPP procurement to use the existing negotiation procedure in the EU Utilities Directives in Articles 9, 40 and 54.<sup>629</sup> In accordance with Article 1(9) (c), the negotiated procedures require that the contracting entity consults the economic operators of its choice and negotiates the terms of the contract with one or more of them. In accordance with Article 1(9) (c), the negotiated procedures require that the contracting entity consults the economic operators of its choice and negotiates the terms of the contract with one or more of them.

#### **6. The competitive dialogue – not a solution to the negotiation problem**

When awarding a PPP contract through the competitive dialogue procedure, the contract must be awarded on the sole basis of the award criterion for the most economically advantageous tender, pursuant to Article 29(1), and the public party must set up the needs and demands in the notice document, pursuant to Article 29(2).

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<sup>628</sup> See also H Collins, *Regulating Contracts* (Oxford: Oxford University Press), pp. 308.

<sup>629</sup> Council Directive 2004/17 of 31 March 2004 coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors OJ L134/1-113.

The public party opens a dialogue with the tenders, after the selection in accordance with Article 44 to 52. The aim of the dialogue is to identify and define the means best suited to satisfy the complex needs of the public party. The public party may discuss all aspects of the contract during this dialogue as long as the public party ensures equality of treatment among all tenders according to Article 29(3).<sup>630</sup> When the dialogue is concluded, the tenders submit their final tenders based on the solution specified during the dialogue; see Article 29(6). The public party then assesses the tenders on the basis of the most economically advantageous tender, pursuant to Article 29(7).

Hence, the Member States have a legal obligation to fulfil the requirements of EU Procurement Law by paying constant attention to the restraints flowing from the ban on negotiations in the EC Procurement Directives.

According to the Commission, the competitive dialogue will provide the necessary flexibility in the discussions with the tenders on all aspects of the PPP contract during the set-up phase. At the same time, this procedure will ensure that the dialogue is conducted in compliance with the principles of transparency, equality of treatment, and the EC Treaty principles.<sup>631</sup>

The competitive dialogue is not enough to gain the economic benefits from a PPP. The key legal challenges with regards to PPP in the EU are that it is necessary, in order to benefit fully from a PPP, that the parties can include a high degree of negotiation and collaboration, a measure that, to some extent, is prohibited by the Public Service Directive 2004/18/EC and by the EC legal principle concerning to the ban on negotiation. The competitive dialogue does not allow negotiation. As mentioned above, negotiation in a PPP arrangement is necessary in order to obtain joint utility which is fundamental for achieving more value for money.

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<sup>630</sup> 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, also according to Article 29(3).

<sup>631</sup> Also see Commission (EC), 'Green Paper on public-private partnerships and Community Law on Public Contracts and Concessions' (Green Paper), COM (2004) 327 final, 30<sup>th</sup> April 2004., section 25.

## 7. Recommendations for the future PPP

In a perfect world, the function of a legal framework regarding PPP would reduce opportunistic tendencies and opportunistic behavior between the parties. At the same time, the legal framework would reduce the fear of opportunistic behavior among the parties and align the interest of the partners.<sup>632</sup>

Other economic theories can explain the problems with the existence of a fear of opportunistic behaviour in a contractual relationship. In his transaction cost theory, Williamson explains that opportunistic behaviour is negatively related to safeguards,<sup>633</sup> and Gulati argues that this fear reflects a negative departure from the full change of co-operative relationships maintained by organisations.<sup>634</sup>

It is necessary to acknowledge that one of the key elements in a PPP is the co-operation between the private and public party. However, in general the procurement rules require that the public party, in the tender procedure, sets out almost all conditions, and only minor matters can be changed after the award.<sup>635</sup>

The research literature discusses the necessity of legal support and clear rules of PPP arrangements. Pongsiri argues in regard to developing countries that:

Regulation is a key element to maintain competitive market discipline in public service provisions in developing countries. While many governments in developing countries have already signed their first demonstration public private partnership contracts, many have not yet designed the legal and regulatory framework for monitoring the performance of private contractors and for ensuring contractual compliance.<sup>636</sup>

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<sup>632</sup> J. Hennart, 'A Transaction Cost Theory of Equity Joint Ventures' (1998) 9 (4) *Strategic Management Journal* 361-374.

<sup>633</sup> O. Williamson, *Markets and Hierarchies: analysis and antitrust implications*, (New York: The Free Press, 1975).

<sup>634</sup> R. Gulati, 'The Dynamics of Alliance Formation, Dissertation' 54 *Abstract International* 4170.

<sup>635</sup> See S. E. Hjelmberg, P. S. Jakobsen and S. T. Poulsen, *Public procurement law – the EU Directive on public contracts* (Copenhagen: Djøf, 2006), p. 201.

<sup>636</sup> N. Pongsiri, 'Regulation and public private partnership' (2002) 15(6) *International Journal of Public Sector Management* 487-495, p. 490.

Pongsiri argues further:

Regulatory systems should be established as soon as possible to define clear rules for financial performance, provide practical experiences to the staff responsible for their implementation, and provide assurance to the private sector that the regulatory system includes protection from expropriation, arbitration of commercial disputes, and respect for contracts agreements.<sup>637</sup>

It can also be argued that when co-operation is such an important aim of the PPP, problems arise because the EU, the UN and the WTO procurement rules do not ensure this co-operation. Hence, the principles of the procurement rules are to ensure competition, equal treatment and transparency, but not co-operation.

Co-operation is relying on trust to function. Trust is an indicator of relationship development and a key element in a PPP. Co-operation and trust is significant elements in relationship management. Edkins and Smyth argue:

Relationship management offers an alternative to transaction approaches to exchange reversing the management emphasis of cost reduction and meeting contract condition via the minimum number of points of contracts to management.<sup>638</sup>

Relationship management is a significant part of the PPP arrangement, and includes perceived value, service satisfaction, customer loyalty, relationship value, and profitability.<sup>639</sup>

In a PPP contract encouraging relational contracting, the organisational systems and procedures would be expected to provide some scope for relationship development when using the principles from the relationship management paradigm.

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<sup>637</sup> N. Pongsiri, 'Regulation and public private partnership' (2002) 15(6) *International Journal of Public Sector Management* 487-495, p. 490.

<sup>638</sup> A. J. Edkins and H. J. Smyth, 'Contractual Management in PPP Projects' (2006) *Journal of Professional Issues in Engineering Education and Practice* 82-93, at p. 83.

<sup>639</sup> D. Ford, H. Håkansson and I. Snehota, *Managing Business Relationships* (London: Wiley, 2003).



Edkins and Smyth argue:

This will theoretically create high trust environments, which are sustainable providing all parties show a willingness to trust and invest in relationship development at both individual and organisational levels.<sup>640</sup>

Co-operation and clear legal rules regarding PPP are not only needs in developing countries; they are general needs at governmental level in all countries. The law must ensure the possibility of establishing efficient collaborations between the public and the private sector.

If the legal framework is not working in favor of PPP, legalistic behavior can occur. This situation occurs when the parties bring the 'baggage' from past legal arrangements into the PPP project. This baggage consists of the knowledge of procedures, rules, contract terms, etc., based on traditional procurement projects. It can result in a situation in which the service provider is 'covering his back', acting more concerned with meeting the performance criteria in the contract than seeking real benefits. Such behavior can lead to a breakdown in the relationship and, therefore, the trust and co-operation foundation.<sup>641</sup>

Such a breakdown will lead to self interested behavior and opportunism, which is the opposite of the joint utility and general welfare that the PPP project seeks to obtain.

The aim of specific PPP rules must be to enhance legal certainty and to avoid situations where the legal environment can create opportunistic behavior. Also, legal certainty can alleviate the concerns that traditional procurement rules might make PPPs unattractive or impossible to carry out.

With regard to the legal uncertainty, two approaches are presented below:

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<sup>640</sup> A. J. Edkins and H. J. Smyth, 'Contractual Management in PPP Projects' (2006) *Journal of Professional Issues in Engineering Education and Practice* 82-93, at p.85.

<sup>641</sup> See also: A. J. Edkins and H. J. Smyth, 'Contractual Management in PPP Projects' (2006) *Journal of Professional Issues in Engineering Education and Practice* 82-93, at p.85.

- One approach is that existing public procurement rules and principles cover all PPPs, rendering a definition of PPP unnecessary. This is the natural legal solution. All new ideas and concepts designed to address the demand for new types of co-operation between public and private parties created by the market are governed by the existing rules. However, these rules do not take in consideration that the PPP model has very specific characteristics with regard to the co-operation and output needed to create an efficient PPP.
- Another approach, as presented in chapter 6, is to let the public authorities use the option of co-operating with private parties under conditions similar to market conditions. This solution is in conflict with the procurement procedure in general.

A simple solution is to set up specific PPP rules as part of the public procurement regulation – both in the EU and the WTO - and legally define exactly what a PPP is; how a PPP must be set up; how to ensure a fair and transparent competition when selecting the private parties; and how to run a PPP.

When this is accomplished, the PPP can use a different set of procurement rules which acknowledge the special aims of the PPP; the public service can operate on market conditions with the benefits related to the market; and co-operation can be prioritised. The already-known negotiation procedure from the EU utility directive could be an easy solution.

Thus, if the PPP falls outside the scope of any definition of a PPP, the traditional public procurement rules will apply to the situation. Only when a strict definition of a PPP is fulfilled should the specific PPP rules apply to the PPP.

It should be emphasised that the aim and purpose of the EU Public Procurement Law is good but not when there is a particular need or market for new types of co-operation between public and private parties.

While also subject to special procedural rules, the PPP rules should allow for the special turnaround in the traditional incentive procurement structures necessary for PPP. PPP has the potential to achieve greater economic efficiency by changing the incentive structure of co-operation.