



*The Practical Impact of E.U. Public Procurement Law
on PFI Procurement Practice in the United Kingdom*

by

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LL.M. (Wales)

*Thesis submitted to the University of Nottingham
for the Degree*

Doctor of Philosophy

To

my parents, Christiane and Dr. Eckart Braun,

my sister Ada.

I wish to acknowledge my indebtedness to **Professor Sue Arrowsmith**. I learnt much from her published works, from her lectures and most of all from her detailed criticism of previous drafts of this study. I am also most grateful to her for her constant encouragement and guidance. The thesis benefited immensely from her expertise and her invaluable advice.

I am greatly indebted to **Paul Roberts**, with whom I had many illuminating conversations. Paul enriched the project by his experience in conducting empirical research. His many suggestions were particularly inspiring and highly appreciated.

In July 1998, **Achilles Information Ltd** awarded me a generous scholarship to conduct this research project. I am obliged to everybody at Achilles and in particular to Colin Maund.

I am very grateful for the support this study has received from my **interview partners**, which I cannot name for reasons of confidentiality. I am indebted to them for their willingness to spare their valuable time and their wealth of experience in PFI procurement with me.

The philosopher Martin Buber said “Alles wirkliche Leben ist Begegnung,” which reads in English as “all life is encounter.” It is for this reason that I want to express my gratitude for “Begegnungen” with so many friendly people during my time in Nottingham. Though we did not share a language, in fact Beeston often sounded more like Babel, we discovered that we share an interwoven history and more importantly common values and interests. Some of those people deserve special mentioning in order of appearance.

Martin Dischendorfer, whom I am grateful for many inspiring discussions not only about procurement law. As true Viennese, Martin taught me how to hold proper coffee breaks, even if the Sacher cake had to be replaced with flapjacks. **Elisabetta Piselli** deserves *un abbraccio* for being such a great company during her confusingly

difficult year in Nottingham. To another Italian in Nottingham, my good friend **“Dottore” Francesco Seatzu**, I owe many inspiring discussions about life, academia and other gender specific issues. A great communicator, **Aris Georgopoulos**, joined the club in October 1998 and surprised by his enthusiasm for public procurement law and many other refreshing topics. **Martha Casteñada Ballard** for her unshakeably positive approach to life, studies, coffee breaks and the Mexican parts of Germany. A *hvala lepa* is due to **Tina Eržen**, a very good friend and excellent procurement lawyer, for her virtual morale support over the last two years.

Last but not least I am especially grateful for my encounter with a very special person, **Despina Pachnou**. Despina made me smile so often during those three years and is living proof that life should be a pursuit of happiness and genuineness. I appreciated on a number of occasions her willingness to listen, the discovery of a Mediterranean side of life.

The emergence of Private Finance Initiative (PFI) in the 1990s has been described as the largest cultural change for decades in the way the public sector operates. PFI projects distinguish themselves from traditional methods of public purchasing by their commercial complexity and long contractual term. Most of these projects have to be delivered within the regulatory framework of public procurement which has remained largely unchanged since the 1970s.

The overall objective of the study has been to gain a complete picture of PFI practice in the light of the apparent divergence between the law and commercial requirements. It was aimed to investigate whether this divergence has brought about a “PFI procurement practice.” If so, it was aimed to examine the reasons for the emergence of the practice and whether it deviated from procurement law.

To achieve these objectives, PFI practice was approached from an outsider and insider perspective. The perspective of insiders was gained by conducting a qualitative empirical study based on interviewing PFI experts. The outsider perspective was derived from legal analysis backed up by relevant material provided by interviewees.

The main conclusion of the study is that legal practitioners have adopted solutions in different PFI projects largely resembling each other. The resemblance justifies referring to them as PFI procurement practice. This practice was found to be not always in compliance with a literal interpretation of procurement law.

Factors driving the divergence between law and practice include the perception of practitioners that strict compliance disproportionately hampers the commercially oriented PFI procurement practice. In addition, H.M. Treasury has increased the divergence by publishing guidance notes on PFI procurement which disregard procurement law in many respects. A further reason for the divergence is that private sector bidders have abstained from enforcing procurement law in the courts. In so doing, they have significantly reduced the risk of challenges for authorities developing PFI procurement practice.

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Annex II Sampling chart

AG	Advocate General
BAFO	Best and final offer
BOT	Build operate transfer
BOOT	Build operate own transfer
BothSA	Advisor to both sectors
CBI	Confederation of British industries
CPC	Community product classification
DBOM	Design build operate maintain
DBFO	Design build finance operate
DCMF	Design construct manage finance
DETR	Department of the Environment, Transport and the Regions
E.C.	European Communities
ECJ	European Court of Justice
E.C.R.	European Court Reports
E.U.	European Union
FM	Facilities management
GDP	Gross domestic product
GPA	WTO Agreement on Government Procurement
ISOP	Invitation to submit outline proposals
ITN	Invitation to negotiate
MOD	Ministry of Defence
NAO	National Audit Office
NACE	Nomenclature générale des activités économiques dans les communautés Européennes
NHS	National Health Service
NIRS2	National insurance recording system
OECD	Organisation for economic co-operation and development
OJEC	Official Journal of the European Communities
PFI	Private Finance Initiative
PPP	Public private partnership
PSC	Public Sector Comparator
PSBR	Public sector borrowing requirement
PubSA	Public sector advisor
PrivSA	Private sector advisor
SPV	special purpose vehicle
TEN	Trans European Networks

TTF	H.M. Treasury Taskforce
TUPE	Transfer of Undertakings (Protection of Employment) Regulations 1981 S.I. 1981 No. 1794, based on the Acquired Rights Directive 77/187/EEC, O.J. 1977 L61/27
U.K.	United Kingdom
UNIDO	United Nations Industrial Development Organization
UNISON	U.K. Public sector union
VfM	Value for money

Chapter 1 Introduction

1.1. Private Finance Initiative

In times of limited public budgets, public authorities endeavour to find new ways of financing their public tasks. Especially when delivering capital intensive infrastructure projects, government departments have aimed to harness private sector funds and management expertise by entering into “partnerships” with private sector companies.

The term public-private partnerships (PPP) encompasses a variety of qualitatively very different arrangements that involve the use, to varying degrees, of private sector funding and expertise. PPPs enable some countries to establish urgently required public infrastructure for the first time, including the delivery of roads and facilities for water and sewage treatment. In other countries, PPPs allow government departments to meet an increasing demand for high quality public services by improving or updating existing infrastructure.

In the United Kingdom, investments in the public infrastructure and public services have been falling in real terms for years leading to a significant backlog of infrastructure investments. Under those circumstances, PPPs are intended to provide governments with the opportunity to improve the delivery of services to the public without increasing public spending and the public sector net requirement.

It is for these reasons that the Private Finance Initiative (PFI) was adopted in the United Kingdom. The PFI scheme implemented an elaborate kind of public private partnership. Essentially, PFI projects are arrangements where the government department responsible for the delivery of a public service entrusts the delivery to the private sector under a contract. The private sector contributes the capital for the substantial asset involved in the delivery of the public service. In the example of a prison PFI, the Prison Service no longer procures the prison but “custodial services,” comprising the design, construction, finance and operation of the prison. The adoption

of PFI has been referred to as the “largest cultural change for decades in the way the public sector operates”¹ in the United Kingdom.

1.2. Public procurement law

Public procurement refers to the purchase of goods and services by authorities in the market place from another legal entity, generally by contractual agreement.²

Authorities acquire by means of PFI projects services, works or goods from private sector suppliers. Therefore, PFIs will be generally classified as procurement transactions and come within the realm of procurement law.

Procurement law in the United Kingdom was developed on the basis of five E.C. Council Directives. The major rationale of enacting supra-national rules in this area of law has been to open procurement markets for foreign competitors so as to increase competition in national procurement markets. The latter account for a substantial proportion of the overall economic activity. The state’s direct involvement in the economy appears to make public procurement *per se* susceptible to discriminatory “buy national” practices. It is for this reason that procurement has increasingly become subject to international regulation.³

Apart from the E.U. rules, the international regulatory activities include a number of multilateral and bilateral trade agreements.⁴ Like the other agreements, European procurement law was intended to play a pivotal role in establishing the European Single Market. The European legislator enacted transparent procurement procedures to ensure fair competition and equal access to government contracts for bidders from all

¹ Lindrup/ Godfrey, *Butterworths PFI Manual* (1999), para 1.

² Arrowsmith, *The Law of Public and Utilities Procurement* (1996); Digings/Bennett, *E.C. Public Procurement* (1992); Fernandez Martin, *The E.C. Public Procurement Rules: a critical Analysis* (1996); Trepte, *Public Procurement in the E.C.* (1993); Weiss, *Public Procurement* (1993); Prieß, *Das Öffentliche Auftragswesen in der Europäischen Union* (1994); Bright, *Public Procurement Handbook* (1994); Bovis, *Public Procurement Law in the EC* (1997).

³ Wallace terms this development “global revolution” in “The changing world of national procurement systems” (1995) *P.P.L.R.* p.57.

⁴ WTO “Agreement on Government Procurement” (GPA), APEC “Document on Principles of Transparency in Government Procurement,” Ch.10 of Nafta and the E.U./USA bilateral agreement.

Member States. The E.U. procurement rules and the implementing U.K. Regulations govern the award of many PFI projects. However, as European procurement law dates back to the 1970s, a significant issue is whether the legislative framework can cope with the challenges posed by a changed socio-economic environment, including the development of innovative methods of procurement such as PFI.

1.3. The current study

1.3.1. Aims of the study

The aim of this qualitative study is to increase the understanding of procurement law in analysing its practical application and its resulting impact on PFI procurement practice. Understanding the reasons that led to the adoption of a legal practice and the extent to which the law impacted on the practice is paramount for a possible re-evaluation of the law in the books.

At first glance, it appears possible that the emergence of PFI has resulted in a divergence between the commercial reality of procuring PFI and the rigid legal requirements of procurement law. For example, authorities may find it difficult to procure complex PFI contracts by following rigid and formalised tendering procedures without having recourse to extensive negotiations with bidders and project lenders. The possible discrepancy between commercial reality and the law may have caused a number of difficult legal questions.⁵

The complexity of the legal issues in PFI procurement raises questions of considerable interest. Given a lack of bespoke procurement rules for PPPs, authorities have to apply norms which were designed for contracts of much less complex structure. The resulting difficulties in applying a probably inadequate legal framework to complex procurement tasks may disproportionately hamper the procurement process.

⁵ H.M. Treasury, "PFI: Public Procurement Issues," paper delivered at "Public Procurement: Global Revolution" Aberystwyth, September 11-12, 1997.

Analysing these issues and the ways in which procurement law has been practically applied in PFI is of relevance for legal practitioners working for government departments and private sector companies alike. Increasing the understanding of how procurement law is applied in a commercial situation for which it was not designed is further of interest to supra-national institutions involved in the European legislation process. They will be interested to learn whether the legal framework they have perceived is functioning effectively under the changed socio-economic circumstances. As an increasing number of other European countries are implementing private finance schemes modelled on the experiences gained in the U.K. with PFI, their national governments will want to increase their understanding of the difficulties surrounding PFI procurement practice. What is more, scholars of E.U. Law should be interested in a study looking at the impact *and* insider perception of one of the legal cornerstones of the Single Market.

Previous studies in procurement law and the majority of studies in other areas of European Union law have focussed on the impact of the law in the books on its addressees. In E.U. Law, the European Commission regularly conducts or commissions studies measuring the economic impact of rules constituting the Single Market.⁶ In addition, there are academic studies dealing with specific areas of E.U. law analysing its impact on the national legal systems of the Member States and the role of Community institutions meant to ensure its effectiveness.⁷

As a result of those studies, some progress has been made towards understanding the behaviour of addressees of supra-national law implemented by national regulatory measures. Those studies have additionally explored the nature and preconditions of the effectiveness of Community law as well as the principal means of ensuring it.

⁶ European Commission, *Single Market Review Series* (1996) with subseries related to the impact on manufacturing, services, dismantling of barriers to trade, trade and investment, competition and scale effects and regional impact; European Commission, *The Impact and effectiveness of the Single Market*, COM(96) 520 final, 30 October 1996.

⁷ Snyder, "The Effectiveness of European Community Law: Institutions, Processes, Tools and Techniques" (1993) *Modern Law Review* p.19.

In the area of public procurement, only a few impact studies have been published.⁸ The most detailed study of the overall economic impact of procurement law was published by *EuroStrategy Consultants*.⁹ In the specific area of PFI procurement, there have been some quantitative studies with the aim to gauge the impact the PFI scheme has made on the construction industry.¹⁰

One common aspect of impact studies on procurement law is that they are based on quantitative data or pure legal analysis. In addition, the analysts have adopted outsider perspectives. Their studies described socio-legal phenomena, but neglected subjective aspects, such as the motivation of insiders, their experiences and meaning attached to behavioural strategies adopted.

Furthermore, none of the impact studies analysed the living procurement law, meaning its practical application, and its possible divergence from the procurement law in the books. So far, explanation was sought by studying externalities. No data are available at all on how practitioners perceive PFI procurement practice or, when they do not follow E.U. law, why they perceived it necessary to diverge from the law in the books. Additionally, there is no qualitative data on the impact of procurement law on PFI procurement practice.

1.3.2. Outline of the study

The study falls broadly into four parts which this section will briefly outline. The first part comprising chapter 2 and 3 introduces the two main concepts the study is

⁸ Cox, "E.U. Procurement Policy: Public and Private Obstacles to the Creation of the Single European Market" (1992) *P.P.L.R.* p.139; Hartley/Uttley, "The Single European Market and Public Procurement Policy: the Case of the United Kingdom" (1994) *P.P.L.R.* p.114; Cox/Furlong, "The jury is still out for utilities procurement: the impact of the EU procurement directives on the location of utilities contract awards in the twelve "member" states" (1996) *P.P.L.R.* p.57; Telgen/de Boer, "Experience with the E.C. Directives on Public Procurement: a survey of Dutch Municipalities" (1997) *P.P.L.R.* 121; Fernandez Martin, op.cit., note 2, ch.1; Bohann/Redonnet, "E.U. Procurement Legislation: Does the Emperor Have Clothes? An Examination of the New Empirical Evidence" (1997) *P.P.L.R.* 141; Gordon/Rimmer/Arrowsmith, "The economic impact of the European Regime on Public Procurement: Lessons for the WTO" (1998) *World Economy* p.159; Bovis, *An Impact Assessment of the European Public Procurement Law and Policy* (1999) *J. of Business Law* pp.126.

⁹ EuroStrategy Consultants, *Single market review series. Subseries 3, Dismantling of barriers v.2 – Public Procurement* (1997).

¹⁰ Birnie, "PFI – UK Construction Industry Response" (1999) *Construction Procurement* p.5.

dealing with, namely PFI and procurement law. Chapter 2 will map out the objectives and the underpinning of PFI and its three different types of projects. It will also outline the advantages of PFI and the obstacles government have to face in carrying out projects.

Chapter 3 will then turn to the legal framework within which many PFIs have been delivered, namely procurement law. The chapter will outline the economic rationales of regulating public procurement on an international level before turning to the European regime which underlies the U.K. Regulations. It will map out the need for further research into questions related to the practical application of the “law in the books” in PFI.

Chapter 4 can be viewed as the second part of the study, mapping out how the study aims to learn more about the practical application of procurement law, its possible discrepancy from the law, its explanations, and the forces and institutions sustaining it. To find out more about the reasons why the legal practice was adopted in PFI procurement and to understand the views, and perspectives of practitioners, an empirical research was conducted. Chapter 4 will outline the methodology of the empirical study, its design, and the underlying legal theory. It will then sub-divide the main research question related to the practical application of the law into a number of more specific research questions.

The third part of the study, comprising chapters 5 to 11, will then turn to seven of the most pertinent legal problems and uncertainties arising from the practical application of procurement law. The seven uncertainties are not only relevant in PFI but previous studies have identified many of the uncertainties as negatively influencing the legal effectiveness of procurement law in general.¹¹ Chapters 5 to 11 will further explore the salient question what impact procurement law has had on PFI procurement practice. This will be achieved by comparing in each chapter the

¹¹ EuroStrategy Consultants, op.cit., note 8, p.70.

uncertain legal situation with the solution adopted by practitioners.

The fourth and final part of this research project describes in chapter 12 common themes arising from the seven specific problems and uncertainties and draws in chapter 13 a general conclusion. Firstly, chapter 12 will highlight the development of PFI procurement practice. At a second stage, the chapter will explain why the practice emerged, before turning to exploring its main characteristics. In a fourth section, chapter 12 will shed some light on the impact of procurement law on PFI procurement practice from an insider and an outsider perspective. If it is found that the living law diverges from the law in the books, the risk for the authority to be challenged will consequentially increase. Chapter 12 will address this question in detail and highlight the considerations taken into account by authorities and bidders.

Chapter 13 will firstly consider PFI procurement from an outsider perspective in examining the law's impact on the legal practice. It will then analyse the perspective of insiders in discussing their subjective perception and interpretation of the law. The integration of both perspectives aims at providing the study with a complete picture of the procurement practice in PFI.

Chapter 2 The Private Finance Initiative

Chapter 2 sets out in its first part the formative context of the initiative, its evolution and related concepts. The following sections will concentrate upon the questions of why the government adopted PFI, what rationales are underlying the scheme and, finally, what obstacles government had to face when implementing the scheme. The last two sections of this chapter consider the different types of PFI projects and their corporate and contractual structure.

2.1. *Background and evolution of PFI*

The return of a Conservative-led government in 1979 marked the beginning of series of initiatives attempting to transfer the responsibility for the delivery of non-core government goods and services away from the public sector to the private sector. The initiatives included the privatisation of state-owned industries and the contracting out of public sector activities, and then the Private Finance Initiative.¹

The Thatcher government launched the privatisation programme in 1979 at a time when nationalised industries accounted for one-tenth of the national output and some 1½ million employees.² It was perceived that the essential reason for widespread inefficiency and significant losses of these industries was that their survival did not depend upon pleasing consumers as they were not genuinely exposed to market pressure.

As a part of the privatisation programme, the Treasury set up a committee led by Sir William Ryrie which reported in 1981 on the use of private finance to fund public sector projects. On the basis of the “Ryrie rules”³ developed by this committee, a relatively small number of high profile transport-related infrastructure projects were undertaken, such as the Channel Tunnel (1985), the Dartford Crossing (1987) and the

¹ H.M. Treasury, *Public Private Partnerships – The Government’s Approach* (2000), p.25.

² Brown/Ridley, *Privatisation* (1994), p.139.

³ The original set of the “Ryrie rules” had to principal themes: a privately financed solution had to be tested against a publicly funded alternative and shown to be more cost-effective. Secondly, privately financed expenditure could not be additional to public expenditure provision.

Second Severn Crossing (1990).

On 12 November 1992, the then Chancellor of the Exchequer, Norman Lamont, launched in his Autumn Statement the “Private Finance Initiative” (PFI) to promote the notion of private finance in order to deliver “higher quality and more cost-effective public services.”⁴ With this statement, the government inaugurated the encouragement of joint ventures between the private and the public sector, particularly for the performance of large infrastructure projects which would otherwise not be affordable to the public sector. Important features of the original launch in 1992 were that the self-financing private projects were no longer required to be compared against a theoretical public sector solution⁵ and the encouragement of the private sector to lead joint ventures with the public sector.⁶

Due to the lack of impact, the Initiative was re-launched in 1993 together with the creation of the “Private Finance Panel” and the publication of the first PFI guidance *Breaking New Ground – towards a new partnership between the public and private sector*.⁷ Since March 1995, there has been, in effect, a “presumption” in favour of PFI in the United Kingdom central government. The Treasury did not authorise expenditure on a capital project unless the viability of the PFI approach had been tested. Testing the suitability of the PFI approach meant that authorities had to seek expression of interests and running a competition based on a PFI solution.

The new Labour government abolished this requirement within days of coming into power in May 1997, considering it as being too restrictive and one source of delay. Instead of pursuing a categorical approach, the new administration stressed its determination “to make PFI work where appropriate.”⁸ Hence, the presumption that the private sector always provides the better route for delivering services to the public

⁴ H.M. Treasury, Private Finance Panel, *Private Opportunity, Public Benefit* (1995), p.1.

⁵ This implied *de facto* the abandonment of the Ryrie rules, Fox/Tott, *The PFI Handbook* (1999), p.7.

⁶ H.M. Treasury, *Joint Ventures – Guidance for Departments* (March, 1993), para 4.

⁷ H.M. Treasury, *Breaking New Ground – towards a new partnership between the public and private sector* (November 1993).

⁸ H.M. Treasury, Treasury Taskforce, *Partnerships for Prosperity* (1997), Chapter 4.

was replaced by the strategy that makes best use of what both sectors have to offer in effective public private partnership (PPP).⁹ The Labour administration further reinvigorated and streamlined the Private Finance Initiative by swiftly implementing measures recommended by Sir Malcolm Bates in his first “Bates Review.”¹⁰

The recommendations concerned the institutional structure of the Treasury, the procurement process, learning lessons, and minimising private sector bid costs. The change in the institutional structure implied the winding up of the Private Finance Panel¹¹ and the establishment of the Treasury Taskforce, which was meant to focus not only on policy issues, but also on supporting individual authorities in the delivery of PFI projects.¹² The latter function allows the Taskforce to test the commercial robustness of significant projects before the formal procurement process is commenced. This helps projects to deliver the individual project within an acceptable timetable and avoiding potentially abortive expenditure.

The Treasury Taskforce has published a considerable number of generic guidance notes,¹³ policy statements dealing with policy issues arising from the implementation of PFI,¹⁴ technical notes providing guidance on how to implement certain aspects of the PFI,¹⁵ case studies of PFI solutions already carried out¹⁶ and, finally, documents on

⁹ DETR, *Local Government and the Private Finance Initiative* (1998), preface.

¹⁰ H.M. Treasury, *Review of PFI (Bates Report), Summary* (1997).

¹¹ Ibid., at p.7.

¹² Ibid., at p.7-9.

¹³ *A Step by Step Guide to the PFI Procurement Process* (1999).

¹⁴ *PFI and Public Expenditure Allocations* (1997); *Public Sector Comparators and Value For Money* (1998); *PFI and Public Expenditure Allocations for NDPBS* (1998); *PFI Projects: Disclosure of Information and Consultation with Staff and Other interested Parties* (1999); *Provision of Information to Parliament* (2000).

¹⁵ *How to Account for PFI Transactions* (1999); *How to follow the E.C. Procurement Rules and Advertise in the OJEC* (1998); *How to Appoint and Manage Advisors to PFI Projects* (1998); *How to Appoint and Work with a Preferred Bidder* (1999); *How to Construct a Public Sector Comparator* (1999); *How to Manage the Delivery of Long Term PFI Contracts* (1999); *How to Achieve Design Quality in PFI Projects* (2000).

¹⁶ For Example: Highway Agency, *DBFO – Value in Roads - A case study on the first eight DBFO roads* (1997); Treasury Taskforce, *The IND Caseworking Programme* (1997); Ibid., *Lewisham Extension to Docklands Light Railway* (1999); Ibid., *Lowdham Grange Prison Service; Report on the Procurement of Custodial Services in DCMF prisons* (1999); Ibid., *Colfox School, Dorset – A Case Study on the first DBFO School Project* (1998).

the standardisation of PFI contracts.¹⁷ Sir Malcolm Bates was asked in 1999 to report on the progress made in implementing the findings of his first review. In March 1999 he submitted recommendations mainly concerned with streamlining the PFI procurement process and reforming the institutional structure.¹⁸ One contested proposal of the second Bates report was to substitute the successful Treasury Taskforce for a Public Private Partnership called “Partnerships U.K.” This body is supposed to carry on the work of the Treasury Taskforce’s project arm, *inter alia* in bundling together projects such as schools in different authorities to make deals big enough,¹⁹ and to invest in projects in the United Kingdom and elsewhere.²⁰

As other Member States of the European Union have been turning increasingly towards the private finance approach,²¹ PFI has become in recent years an export industry for British banks, legal advisers, and other companies with PFI experience. Those entities had the opportunity during the past few years to acquire an invaluable set of skills in private financing and are now much-in-demand experts overseas.²²

2.2. Public Private Partnerships

Public Private Partnerships are supposed to bring the public and private sector together in a long term partnership for mutual benefit.²³ Although the terms Private Finance Initiative (PFI) and Public Private Partnership (PPP) are used interchangeably, it is suggested that the term Public Private Partnership should be used

¹⁷ General standardisation document: *Standardisation of PFI Contracts* (1999); *Standardisation of IT Contracts* (2000).

¹⁸ H.M. Treasury, *Second Review of the Private Finance Initiative by Sir Malcolm Bates – Summary of Recommendations* (1999).

¹⁹ *Financial Times*, December 13, 1999.

²⁰ It was this function that sparked criticism amongst PFI practitioners who feared that such a solution would result in a conflict of interests: on the one hand Partnership U.K. is supposed to maximise its profits whilst by taking equity shares, whilst on the other hand it has to fulfil the role as an altruistic facilitator of projects helping to find the best deal for the respective government department.

²¹ This goes in particular for Italy, cf. Piselli, “PPPs in Italy: Some important Developments” (2000) *P.P.L.R.* CS21; Ministero del Tesoro, *Summary of activities of the Unità tecnica finanza di progetto*. The Netherlands and Ireland also adopted PPP programmes in the last two years, which are closely modelled on the United Kingdom Private Finance Initiative: each of those three countries has established a central taskforce to lead, drive and co-ordinate the PPP process.

²² *Financial Times*, 19 August 1999; H.M. Treasury, *op.cit.*, note 1, p.9.

²³ H.M. Treasury, *op.cit.*, note 1, p.10.

as an umbrella term for co-operative business structures and partnership arrangements between the public and the private sector. This concept includes arrangements from the Private Finance Initiative and “contracting out” to joint venture companies and to the sale of equity stakes in state-owned businesses.

2.2.1. Definition of PPP

There is no common understanding of the concept of Public Private Partnerships²⁴ and the academic commentators agree only on the very basic feature that such partnerships require the involvement of a public sector body and a private sector company. A contractual relationship linking the two parties is largely deemed dispensable,²⁵ though it is, especially in more complex projects, a “common factor.”²⁶

Mainly due to the elusiveness of its definition, the term Public Private Partnership designates a heterogeneous range of co-operative ventures between the public and the private sector reaching from informal co-operations²⁷ to complex long-term contractual relationships related to a specific asset. This wide definition has sparked criticism from some academic writers for including every contact between private and public sector in the definition of Public Private Partnership.²⁸ Budäus and Kouwenhoven attempt to illuminate the basic dimensions of the PPP definition by choosing the “degree of formalisation” and the “degree of how the aims of the partners are complementary” as constituent criteria. Pursuant to this definition, partnerships can be both of informal or formal nature and may be institutionalised by the

²⁴ See: Arrowsmith (ed.), *Public Private Partnerships and PFI* (2000), para 1.004; Lawless, “Öffentlich-private Partnerschaften in Großbritannien - Analyse und Kritik,” in: Heinz (ed.) *Public Private Partnership- ein neuer Weg zur Stadtentwicklung?* (1993), p.212; Budäus/Grüning, “Verwaltungsreform und Public Private Partnership,” in: Ellwein/Grimm/Hesse/Folke/Schuppert (eds.), *Jahrbuch zur Staats- und Verwaltungswissenschaft*, vol. 9/1996, p.121.

²⁵ Budäus/Grüning, op.cit., note 24, p.121 et.seq.; Kouwenhoven, “Public-Private Partnership: A Model for the Management of Public-Private Cooperation,” in: Jan Kooiman (ed.), *Modern Governance - New Government - Society Interactions* (1993), p. 120.

²⁶ Arrowsmith, op.cit., note 24, para 1.004.

²⁷ For example: Allegheny Conference on Community Development in Pittsburgh established in 1943 to strengthen the economic development of the Pittsburgh region. This conference was the starting point for a network of informal joint ventures between the public and the private sector *inter alia* aimed at re-developing the inner city.

²⁸ Budäus/ Grüning, op.cit., note 24, p.125-127.

establishment of a company. Of crucial importance to the partnership is a high degree of complementary aims²⁹ allowing both parties to maximise their synergy gains.

Four of the most common types of arrangements falling within the scope of the PPP concept are outlined below.

2.2.2. Contracting out

Contracting out, or outsourcing, describes all circumstances where an independent private entity is given responsibility for the day-to-day carrying out of services previously carried out by the government.³⁰ This includes that cleaning services which were previously supplied “in-house” by public sector staff are transferred to a private sector contractor. In contrast to the private finance approach, the contracting out of hitherto public services does not necessarily mean that the private contractor finances the project.

Governments across the globe have employed contracting out policies in order to achieve efficiency gains, while maintaining or increasing service quality levels.³¹ In the United Kingdom of the early 1990s, contracting out was predominantly used to improve the quality of public services and to make them respond better to the wishes of their users, by expanding choice and competition.³² All government departments were required to perform “market testing” exercises to compare costs and quality of the services delivered in-house with what private sector undertakings could offer.³³

It is noteworthy, that governments in many countries not only outsourced ancillary services, such as cleaning of accommodation, to private sector companies but also the actual delivery of public services, including prison services, refuse collection and public transport.³⁴ In these instances, where a long-term agreement establishes a

²⁹ *Ibid.*

³⁰ OECD, *Contracting Out – Best Practice Guidelines and Case Studies* (1997); Sutcliffe, "Contracting Out Public Services: U.K. Policy v EC Law" (1993) *Anglo American Law Review* p. 337.

³¹ See: Ascher, *The Politics of Privatisation: Contracting Out Public Services* (1987).

³² H.M. Treasury, *Competing for Quality* (1991).

³³ Arrowsmith, *op.cit.*, note 2 of ch.1, pp.621-648.

³⁴ Prieß, “Privatisations and the E.C. Public Procurement Rules” (1998) *P.P.L.R.*, p.2.

substantial connection between the private, contracts for contracting out public services are coming in the United Kingdom under the umbrella of Public Private Partnerships.³⁵

2.2.3. Joint venture companies

The archetype of Public Private Partnerships are joint venture companies jointly owned by the private and public sector, to which both parties contribute assets, finance or expertise.³⁶ These businesses will be generally set up for a specific purpose and can be either of long term or short-term nature. Although this form of PPP provides the parties with utmost flexibility when tailoring the company to the specific purpose, joint venture companies are not widely used in the United Kingdom due to legal constraints placed especially on local authorities³⁷ and NHS Trusts.³⁸

2.2.4. Introduction of private sector ownership

A third type of Public Private Partnership is the introduction of private sector ownership into state-owned businesses.³⁹ There is a range of possible options to involve private sector companies into the delivery of public services by means of introducing ownership, such as bringing in strategic private sector partners or selling either a majority or minority share of a floated state-owned business. The introduction of private sector ownership can be categorised as PPP, only if private and public sector engage in some kind of co-operative activity subsequent to the change in ownership.

2.2.5. Private Finance Initiative

The most notable examples of Public Private Partnerships in the United Kingdom are the many schemes delivered under the Private Finance Initiative. PFI has been initially launched in 1992 and its prime focus at that time was on the improvement of

³⁵ Arrowsmith (ed.), op.cit., note 24, para 1.008.

³⁶ For local governments see: Bennett/Krebs, *Local Economic Development – Public-Private Partnerships in Britain and Germany* (1991).

³⁷ Arrowsmith (ed.), op.cit., note 24, chapter 5.

³⁸ Since NHS Trusts are prohibited from holding shares in companies, establishing joint venture companies is not a viable option for them.

³⁹ H.M. Treasury, op.cit., note 1, p.10.

the transport infrastructure, ranging from roads,⁴⁰ bridges,⁴¹ and tunnels to light railway⁴² and tramway projects. Since then, PFI has been employed to deliver a diverse array of projects such as the provision of IT services,⁴³ the construction and refurbishment of NHS hospitals,⁴⁴ local schools⁴⁵ and government accommodation,⁴⁶ military equipment⁴⁷ and most notably prisons.⁴⁸

The main feature of “Private Financed Projects” is to entrust the management of a hitherto public service or facility to the private sector, the private sector providing the necessary capital for a substantial asset. Besides the provision of private capital, the private sector is responsible for the design, construction, and management of the facility.⁴⁹

At the heart of the PFI approach lies a fundamental shift of focus in public sector purchasing. Government departments no longer acquire the asset or infrastructure, but

⁴⁰ NAO/DETR, *The Private Finance Initiative: The First Four Design, Build, Finance and Operate Roads Contracts*, (1998); Highway Agency, op.cit., note 16; NAO, *The First Four Design, Build, Finance and Operate Road Contracts*, 47th Report (1998); HM Treasury, Treasury Taskforce, *A Case Study on the first eight DBFO road contracts and their development* (1997).

⁴¹ Committee of Public Accounts, *The Skye Bridge*, 42nd Report (1998); NAO, *The Skye Bridge* (1997).

⁴² HM Treasury, Treasury Taskforce, op.cit., note 16 (Lewisham).

⁴³ HM Treasury, Private Finance Panel, *The Private Finance Initiative and Government IS/IT* (1994); HM Treasury, Treasury Taskforce, *Private Finance and IT: A Practical Guide* (1998); Federation of Electronic Industry, *The Private Finance Initiative (PFI) & Information Systems Information Technology (IS/IT)* (1996); HM Treasury, Treasury Taskforce, *PFI and IS/IT case study: OSIRIS (Office Systems Infrastructure Review and Implementation for the Welsh Office)* (1998); Sternberg/ Carter, “Are successful IT Projects really deliverable?” (1999) *PFI Intelligence Bulletin* (Oct.); HM Treasury, Treasury Taskforce, *ES/EDS IT Partnership – PFI Case Study* (1999); Committee of Public Accounts, *Improving the Delivery of Government IT Projects* (2000).

⁴⁴ NHS Executive, *Private Finance and Capital Investment Projects* HSG (95)15 (1995); NHS Executive, *Public Private Partnerships in the National Health Service: The Private Finance Initiative – Good Practice* (1999); NAO, *The PFI Contract for the new Dartford & Gravesham Hospital* HC 423 1998/99 (1999).

⁴⁵ HM Treasury, Treasury Taskforce, op.cit., note 16 (Colfox); Middleboe, “School Report – Private Finance for Education” (1994) *New Civil Engineer/ New Builder* (PFI Supplement July) p. 34.

⁴⁶ HM Treasury, Private Finance Panel, *PFI in Government Accommodation - Practical Guidance to the Private Finance Initiative* (1996).

⁴⁷ Ministry of Defence, *Private Finance Initiative: Guidelines for the MOD*; Ibid., *Private Finance and IS/IT – Case Study TAFMIS... and after* (1998); NAO, *The Private Finance Initiative: The Contract for the Defence Fixed Telecommunications System*, HC 328 Session 1999-00 (March 2000).

⁴⁸ NAO, *The PFI Contracts for Bridgend and Fazakerley Prisons* (1997).

⁴⁹ Similarly: Arrowsmith (ed.), op.cit., note 24, para 1.009.

let a contract to private sector company to provide the services related to the asset.⁵⁰ This means, for instance, that the Prison Service no longer procures prisons but “custodial services,” comprising the design, construction, finance and maintenance of the prison. Subsequent to the completion of the asset, the private sector company is reimbursed for the delivery of the public services either by means of a periodical sum, including prison projects, or by the right to levy charges on the end-user of the facility, such as in the case of a toll bridge.⁵¹ The level of payment by the public sector is based on performance of the private sector operator against agreed level of services.⁵²

PFI is further based on the assumption that public and private sector should limit their activities to certain core “business areas.” Whilst the public sector should establish the framework for provision of public services, decide what services should be provided and subsequently ensure that they are properly provided, the private sector should be responsible for the actual provision of the service.⁵³ Hence, PFI seeks to achieve its economic aims by fundamentally changing the role of government and simultaneously expanding the scope for private enterprises.⁵⁴ Moreover, by engaging private sector companies in the provision of classical public services, the line between private and public sector is blurred and, consequently, serious accountability issues arise.⁵⁵ For example, prisoners have to be guaranteed their basic human rights while being held in privately managed custody.⁵⁶

The following section discusses the socio-economic circumstances which paved the way for the PFI, its underlying rationales and the difficulties encountered by the British government in implementing the Initiative.

⁵⁰ H.M. Treasury/ Private Finance Panel, *Risk and Reward in PFI Projects* (1996), p.5; H.M. Treasury, op.cit., note 8 of ch.2, para 3.01; Lindrup/ Godfrey, op.cit., note 1 of ch.1, para 70 et.seq.

⁵¹ For a more detailed account on the payment mechanisms, see below: Chapter 2, III.

⁵² DETR. op.cit., note 9, para 1.7.

⁵³ H.M. Treasury, op.cit., note 1, p.10 et.seq.

⁵⁴ Bailey, *Public Sector Economics* (1995), p.136.

⁵⁵ Taylor, *Private Prisons and Public Accountability* (1997).

⁵⁶ The question arises of whether the private sector company can and should be directly accountable to citizens using the public facility. Taylor, “Public Private Partnerships – Third Way or muddled middle?” (1999) *Public Finance* (October) p.20.

2.2.5.1. *Reasons for adopting PFI*

In its early days, projects procured under the auspices of the Private Finance Initiative have required substantially more time and financial resources in comparison to conventional infrastructure procurement⁵⁷ where the government owns and operates the asset. The question arises, why virtually every government department in the United Kingdom has employed this scheme despite the costs and complexity of the PFI procurement process.

There are, generally speaking, three socio-economic circumstances why the government embarked on the PFI scheme. These are significant cash constraints, the urgent need of infrastructure investment and procurement failures of the past.

The considerable cash constraints faced by governments are one macroeconomic reason for adopting the PFI scheme.⁵⁸ These constraints are reflected in the tension between the limited opportunities to increase public expenditure through increased taxes or public sector borrowing⁵⁹ and the ever-higher expenditure demands by social services budgets, such as social security, health and education, and public infrastructure maintenance.⁶⁰

In traditional procurement, government is paying up front for major assets used to provide public services and, hence, the capital spent on the asset adds to the current government spending and to the public sector net cash requirement – the measure that the financial markets regards as the best guide as to whether the government is spending prudently.⁶¹ In PFI procurement, the payments for the asset are spread over a period of years. This practice allows the deferring government expenditure and reducing total public expenditure, particularly capital spending.⁶²

⁵⁷ H.M. Treasury, op.cit., note 10, p.4, p.11-17; NAO, op.cit., note 40, pp.23-25.

⁵⁸ Artis (ed.), *The U.K. Economy* (1996), p.199 et.seq.

⁵⁹ Bailey, op.cit., note 54, Part I, Chapter 5.

⁶⁰ Lindrup/ Godfrey, op.cit., note 1 of ch.1, para 3-21.

⁶¹ Bailey, op.cit., note 54, Part II, Chapter 11.

⁶² Bailey, op.cit., note 54, p.136.

For example, a conventionally procured hospital involves the government paying a large sum up front for the design, construction and equipping the hospital building. With the PFI approach, government can defer the payments for the new hospital and make a series of payments over a period of 20 to 30 years⁶³ and, additionally, the private finance employed does not count towards the PSBR.⁶⁴ This effect makes the PFI approach attractive for governments, which can deliver improved services to the public without having to pay for it immediately. The mechanism of deferring public spending has sparked considerable criticism for pursuing a “buy now pay later” policy, applying “creative accounting” measures and procuring public projects “off the balance sheet.”⁶⁵

The second reason why the U.K. government initiated the PFI approach is the significant backlog of infrastructure investment.⁶⁶ In 1962, a national plan promised 224 new hospitals and nearly 40 years on, only a third have been delivered.⁶⁷ A similar picture can be drawn of the education sector, where a significant percentage of the classroom space is provided by accommodation which was categorised as “temporary” when first brought into use over 30 years ago.⁶⁸ PFI facilitates the required investment in neglected infrastructure⁶⁹ whilst simultaneously allowing the government both to control the public sector borrowing requirement and to reduce the usual tax implications.

Another main political driver for launching the Private Finance Initiative was that

⁶³ Arrowsmith, op.cit., note 24, para 2.001 et.seq.

⁶⁴ Artis (ed.), op.cit., note 58, p.203.

⁶⁵ See for instance: “Mr Clarke’s free lunch” *The Economist* (January 28, 1995); “Cooking the books,” *The Economist* (October 28, 1995); “Public Spending. Initiative test.” *The Economist* (June 29, 1996); “Public Spending – Farewell straightjacket” *The Economist* (July 18, 1998); “Punch-up ahead?” *The Economist* (June 30, 2001).

⁶⁶ H.M. Treasury, op.cit., note 1 of ch.2, p.13.

⁶⁷ “How Britain mortgaged the future” *New Statesman* (18 October 1999); in comparison, NHS Trusts signed between May 1997 and March 2000 contracts for 35 major hospital project.

⁶⁸ Lindrup/ Godfrey, op.cit., note 1 of ch.1, para 9.

⁶⁹ Alan Milburn, Chief Secretary to the Treasury said at the launch of the IPPR Commission into PPPs: “PPPs make possible more investment in our key public services after years of systematic under-investment. Over the last Parliament public sector net investment fell by 1 per cent of GDP (and by 2 and a quarter per cent of GDP between 1979 and 1997,” H.M. Treasury News Release 152/99, 22/09/1999.

conventional public sector provision of infrastructural projects was perceived to be characterised by time and cost slippage created by over-engineered projects that were frequently changed and poorly managed.⁷⁰ The fact that public servants were operating in a competitive market situation like their counterparts in the private sector was said to be the main reason why hospitals were built behind schedule and housing stock was poorly maintained. These concerns contributed to the perception that private sector companies are more capable of planning, delivering and managing major construction projects than the public sector.⁷¹

Further, the discussion about how to improve traditional procurement methods produced evidence that savings could be achieved by integrating design, construction and operation. It was suggested that the design of the asset should take into account the requirements of an efficient use and maintenance of the asset.⁷² In the United Kingdom, the debates surrounding the shortcomings of conventional procurement methods have coalesced into the PFI, which seeks to harness the managerial skills of the private sector and simultaneously leads to a closer integration of design, construction and operation of public facilities.

2.2.5.2. Rationales underlying PFI

Having briefly discussed the socio-economic framework favouring the adoption of the Private Finance Initiative, the following section will consider its objectives and major rationales.

The primary economic rationale of any PFI arrangement is the creation of a service delivery mechanism that provides better value for money than the

⁷⁰ Committee of Public Accounts, *The PFI Contracts for Bridgend and Fazakerley Prisons, 57th Report* (1998), p.19; H.M. Treasury names four projects which have overspent their original budget 60-200% and faced delays between 2 and 5 years, H.M. Treasury, op.cit., note 1 of ch.2, p.18.

⁷¹ Morrison/Owen, *Private Finance Initiative* (1996), p.1-2.

⁷² This has been identified as a critical factor for the success of a PFI project by a survey amongst PFI experts, Morledge/Owen "Critical Success Factors in PFI Projects," in: Hughes, Will (ed.), *Proceedings 14th ARCOM Conference*, September 1998, p.569; H.M. Prison Service/ Private Finance Panel, *Report on the Procurement of custodial services for the DCMF Prisons at Bridgend and Fazakerley* (1996), p.5.

conventionally procured public sector alternative. One may define *value for money* as the optimum combination of whole life costs and benefits for the public sector. It is uncontested that it is cheaper⁷³ for central government departments than for a private sector company⁷⁴ to raise capital funds. Hence, the higher private sector borrowing costs must be more than offset by savings in other capital and operating costs for private provision to be cheaper and to provide better value for money than the public sector alternative.⁷⁵ The fact that private finance is *per se* more expensive requires public sector purchasers to vigorously compare the costs of the PFI project with the cost of alternative means of provision to ensure value for money.⁷⁶

It is possible to identify five interrelated essential value for money drivers in PFI projects.⁷⁷ Those are private sector management skills, effective risk allocation, the long-term nature of the contract and effective performance measurement and competition.

The first source of cost savings is the private sector's ability to balance cost, risk and return more efficiently than the public administration.⁷⁸ It is assumed that private sector companies operate in a fast moving and competitive environment, which provides them with strong incentives to maximise efficiency and to take full advantage

⁷³ Arthur Andersen claims in its report to the H.M. Treasury that difference is now typically in the range of only 1-3%, Arthur Andersen/ LSE Enterprise, *Value for Money Drivers in the Private Finance Initiative* (2000), para 3.4.

⁷⁴ This is because central government departments do not face the insolvency risk private companies encounter. Hence lending institutions rate them "risk-free." However, local government used not to be rated "risk-free," a situation which is remedied since September 1998. Since then, local governments seek PFI Credits which is in fact an approval scheme for the private sector which indicates that revenue support for the respective PFI project will be forthcoming, cf. DETR, op.cit., note 9.

⁷⁵ This goes although the gap between public and private borrowing is not as high as often suggested, cf. Arthur Andersen/ LSE Enterprise, op.cit., note 73, para 2.1.

⁷⁶ This comparison is accomplished by means of a "Public Sector Comparator" (PSC), which has to be dealt with in detail below in this section.

⁷⁷ A recent report on value for money commissioned by the H.M. Treasury Taskforce suggests six key drivers, namely: risk transfer, the long term nature of contracts, the use of an output-based specification, competition, performance measurement and incentives, and private sector management skills, Arthur Andersen/ Enterprise LSE, op.cit., note 73. Another study suggested that securing value for money is the key rationales of PFI, see: Robinson et al. *The Private Finance Initiative – Saviour, Villain or irrelevance?* (1999), p.13.

⁷⁸ Lindrup/Godfrey, op.cit., note 1 of ch.1, para 184.

of business opportunities. This also means that private sector operators will usually adopt a less risk averse culture than public bodies and are better equipped to challenge inefficient and outdated working practices.⁷⁹

The private sector partner is considered capable of exploiting the assets more intensively due to additional revenues from shared use of facilities and the sale of redundant assets.⁸⁰ By enlarging the asset and sharing its use between the public sector and other customers, or between two or more public sector customers, the private sector solution is susceptible of achieving economies of scale. For example, other private or public customers may also use a computer system delivered under PFI. Thus, the private sector provider may create additional revenue.

These theoretical considerations turn out to be more difficult in practice. The PFI project of the National Insurance Recording System (NIRS2) reveals⁸¹ that the potential additional revenue stream limited in scope and certainly subject to agreement with the contracting authority. Selling products developed as part of the PFI scheme may generate additional revenue, particular skills acquired or experience obtained.⁸²

In addition, private sector participation is also deemed to ensure avoiding “gold-plated” solutions by focusing on outputs instead of over-prescriptive approaches to design.⁸³ The private sector can achieve savings in PFI projects by employing innovative approaches to design, construction, and maintenance and by taking into account more operational considerations into the original design.

Another value for money driver is the efficient allocation of the risks inherent to the project with the partner which best able to manage or mitigate the respective category of risk. Since the notion of optimal risk allocation is one of the major

⁷⁹ H.M. Treasury, op.cit., note 1, p.11.

⁸⁰ Lindrup/ Godfrey, op.cit., note 1 of ch.1, para 185.

⁸¹ H.M. Treasury, op.cit., note 4, p.24.

⁸² *Ibid.*, p.3.

⁸³ PFI has been criticised on this ground, for encouraging “cheap” design of public buildings. This should now be avoided with dedicated Treasury guidance: H.M. Treasury, Treasury Taskforce, op.cit., note 15 of ch.2 (design quality).

rationales of the PFI approach in its own right,⁸⁴ this issue shall be dealt with in a dedicated section below.

The long term nature of PFI contracts has been referred to as a key condition for delivering value for money, because of the scope it provides for the private sector contractor to recover the initial investment, to develop alternative approaches and to focus on whole life costing.⁸⁵ In practice, the contract term will vary between sectors. Projects where a significant proportion of the project cost is devoted to a building may require a contract of 20 to 30 years or longer if best value for money is to be obtained.⁸⁶ Where the expected life of the project assets is only limited, such as by IT systems, difficulties arise in developing mechanisms for technology refreshment and incentivising the contractor to make continuing investments. For example, a 20 year IT contract would be unlikely to offer demonstrable value for money given the pace of change in the sector and the frequent need to replace and up-date systems. Most IT contracts signed to date have consequently been of a shorter length, up to a maximum of 15 years.⁸⁷

The focus on the whole life cycle of a project allows the private sector to offer a complete package, which is in turn a major source of savings.⁸⁸ The designing, building, operating and financing of a project by one company achieves synergies and incentives to base decisions on whole life cycle costs. Furthermore, when a project structure assigns the service provider the responsibility for designing and creating and operating the asset⁸⁹ it is likely to lead towards a closer integration of service needs and design and construction. Thus, new technologies and new, more effective business processes will be applied to ensure that assets are fully fit for their purposes but not

⁸⁴ H.M. Treasury, op.cit., note 4, p.12; Arrowsmith, op.cit., note 24, para 2.035.

⁸⁵ H.M. Treasury, Treasury Taskforce, op.cit., note 15 (preferred bidder), section 4.2.; Arthur Andersen/ LSE Enterprise, op.cit., note 73, para 2.17.

⁸⁶ For example, in a typical highway project, the contract duration is 30 years, NAO, *The Private Finance Initiative: The Contract to Complete and Operate the A74(M)/M74 Motorway in Scotland* (1999), p.8.

⁸⁷ Arthur Andersen/ LSE Enterprise, op.cit., note 733, para 4.35.

⁸⁸ *Ibid.*, para 4.34.

⁸⁹ H.M. Treasury, op.cit., note 4, p.3, p.17.

more, what means removing any tendency to over-design or “gold-plate”⁹⁰ assets and the cost pressure from post-contract design changes

Although it might not be viewed as an absolute pre-condition,⁹¹ competition has been referred to as the best guarantor of value for money,⁹² since it is much easier to demonstrate value for money where there has been an effective price-led competition. In the early days of PFI, public purchasers were faced with a lack of a supplier base and had to create⁹³ and nurture the markets.⁹⁴ The appropriate level of competition was achieved by means of extensive market consultation which were supposed to test the interest of the operators in delivering PFI solutions.⁹⁵ Throughout the procurement process of the project, government departments remain anxious to sustain a competitive market situation from the early planning stages of the project until a very late stage.⁹⁶

However, the costs for preparing a bid for a PFI scheme are genuinely encumbering effective competition between PFI providers.⁹⁷ As tendering for a PFI scheme is an especially cost-intensive process, no more than three or four tenderers⁹⁸ are usually invited to submit a fully priced tender. The dichotomy between a competitive market tendering process and the high bidding costs is reflected in the practice to designate a “preferred” and “reserve bidder”⁹⁹ once the bids have been evaluated. This practice keeps up the competitive pressure on the “preferred” company

⁹⁰ H.M. Treasury, Treasury Taskforce, op.cit., note 8 of ch.2, para 3.08.

⁹¹ *Ibid.*, para 3.09; H.M. Treasury, Private Finance Panel, op.cit., note 4, para 5.16.

⁹² Arthur Andersen/ LSE Enterprise, op.cit., note 733, para 4.45.

⁹³ For instance: custodial industry, H.M. Prison Service/ H.M. Treasury, Private Finance Panel, op.cit., note 72, para 2.2; road operating industry: NAO/ DETR, op.cit., note 40, para 1.4.

⁹⁴ Arthur Andersen/ LSE Enterprise, op.cit., note 733, para 4.48.

⁹⁵ PFI markets are still a long way from being perfectly competitive, meaning that there is a large pool of undifferentiated buyers and sellers and that there is a fair balance between the public and private sectors’ bargaining strengths; Arthur Andersen/ LSE Enterprise, op.cit., note 73, para 4.47.

⁹⁶ Cf. H.M. Treasury, *Competition and the Private Finance Initiative* (1994).

⁹⁷ For instance, in the first four highway projects, the reserve and winning bidders spent bid costs in excess of £4 million, NAO/DETR, op.cit., note 40, 1.33.

⁹⁸ Confederation of British Industry (CBI), *Private Skills in Public Service - Tuning the PFI*, Summary (1996), pp.22-23; H.M. Treasury, Private Finance Panel, op.cit., note 4, para 5.24.

⁹⁹ H.M. Treasury, Treasury Taskforce, op.cit., note 13, stage 12.

during the final negotiation stages, whilst avoiding costs incurred by other tenderers.¹⁰⁰

In order to harness fully the private sector management skills throughout the life-time of the PFI project, authorities have to ensure that the service provider operates in a competitive situation under market disciplines. This means that competitive pressure should be applied to the service provider not only during the procurement process but also, if possible, during the operation phase of the project.

Performance measurement fulfils a different role than the factors discussed above. While the other value for money drivers have a direct impact upon the pricing of the project, performance measurements are a means to ensure that value for money is delivered as promised in the original contract.¹⁰¹

The actual cost savings for the government achieved by PFI and its notion of “sweating the capital”¹⁰² are claimed to be “huge” and are estimated to be between 10% for DBFO road projects and up to 20% for defence projects.¹⁰³ To ensure that the private finance approach is more viable than conventional funding, authorities should employ a “Public Sector Comparator” (PSC).¹⁰⁴ The PSC may be defined as a hypothetical risk-adjusted costing to an output specification¹⁰⁵ which serves as a benchmark against which private sector bids are assessed. A PSC is constructed on the assumption that the procurement is undertaken through conventional funding and that significant managerial responsibility and exposure to risk is retained by the public

¹⁰⁰ Fox/Tott, op.cit., note 5, para 5.7.11.

¹⁰¹ Arthur Andersen/ LSE Enterprise, op.cit., note 73, para 4.38.

¹⁰² CBI, op.cit., note 98, p.12.

¹⁰³ H.M. Treasury, op.cit., note 1, p.17; However, these figures are highly contested. The NAO and critics of the PFI scheme ascertain that departments use high discount rates (8% instead of 6%) and thus significantly overstate the benefits achieved; cf. NAO/DETR, op.cit., note 40, para 2.16 et seq.; Warner, “PFI spotting: the PPP track” (1998) *The Banker* (Sept.), p.25; Broadbent/Laughlin, “Accounting choices: Technical and Political Trade offs and the U.K.’s Private Finance Initiative,” Paper for presentation at the Critical Perspective on Accounting Conference, New York April 1999; a summary of the discussion can be found in: Arthur Andersen/ LSE Enterprise, op.cit., note 73, paras 3.13-3.26.

¹⁰⁴ H.M. Treasury, Treasury Taskforce, op.cit., note 14 (PSC and VfM); H.M. Treasury, Treasury Taskforce, op.cit., note 15 (PSC); H.M. Treasury, Treasury Taskforce, op.cit., note 13, Step 3; H.M. Treasury, *Value for Money in Construction Procurement* (1997).

¹⁰⁵ H.M. Treasury, Treasury Taskforce, op.cit., note 15 (PSC), para 2.3.1.

sector. The PSC should provide the project partners with an ongoing benchmark against which the performance of the project is continually to measure.

The essence of a truly beneficial public-private partnership is the sharing of risks and rewards between the partners.¹⁰⁶ Hence, the second fundamental requirement of the PFI scheme is the appropriate transfer of risk to the private sector. In the context of PFI services, risks relate to any area of the promised service which may fail¹⁰⁷ and they are measured with reference to the potential consequences and cost of failure and the likelihood of occurrence.¹⁰⁸ The evaluation of risk is repeated for each identified category of risk, such as design and construction risk, commission and operating risk, including maintenance, demand volume/ usage risk, technology/ obsolescence risk and Regulation and legislation risk.¹⁰⁹

In transferring risks, the purchasing authority primarily aims to incentivise the private sector to manage and minimise those risks which are within its control.¹¹⁰ The contractor can thus perform efficiently and cost-effectively. An appropriate transfer of risk,¹¹¹ which exposes the private sector companies only to those risks which they are best placed to manage, is likely to offer best value for money to the public sector, although the private sector will attach a price for being exposed to risk.¹¹² The notion

¹⁰⁶ Secretary of State for the Home Department, *The management of the prison service (public and private): the Government reply to the second report from the Home Affairs Committee* (1997), p.4.

¹⁰⁷ H.M. Treasury/ Private Finance Panel, op.cit., note 50; Akintoye/Taylor/Fitzgerald "Risk Analysis and Management of Private Finance Initiative Projects" (1998) *Engineering, Construction and Architectural Management* p.9; Birnie, op.cit., note 11 of ch.1; Pitney/Smith, „Public Transport Systems: The Allocation of Risks in Construction Contracts“ (1998) *Construction Law Journal* p.240; Price/ Shawa, "Risk and Risk Management in Project Related Finance" (1997) *Journal of Construction Procurement* p.27.

¹⁰⁸ Arrowsmith (ed.), op.cit., note 24, para 2.034.

¹⁰⁹ H.M. Treasury, Private Finance Panel, op.cit., note 50, chapter 3.

¹¹⁰ H.M. Treasury, Private Finance Panel, op.cit., note 46, p.24.

¹¹¹ Landers, "Procurement Streamlining: the prison service approach" (1996) *Private Finance Initiative Journal* (5), p.43.

¹¹² This means that the public sector has to weigh carefully whether to retain certain risks or to accept the increased price demanded by the private sector company and consequently to increase the overall costs of the project. See: Grout, "The Economics of the Private Finance Initiative" (1997) *Oxford Review of Economic Policy* p.59.

of best capacity for managing the risk¹¹³ should be reflected in the terminology. Instead of a mere “genuine risk transfer” the second requirement for PFI project should be termed as the “optimum allocation of the risks involved.”

In early projects, authorities sought to transfer too many categories of risk to the private sector contractor irrespective of whether the respective category was better managed by the public sector itself. The most prominent example of transferring risk for its own sake occurred in the first prison project when the Prison Service sought to transfer the “volume risk,” meaning the risk related to the occupancy of prison cells. However, the volume risk lies beyond the control of the private sector company managing the prison, since the supply of prisoners is dependent on the judicial sentencing system and the criminal activity within the community.¹¹⁴

The fundamental structural difference between traditional public procurement and PFI is the transfer of a facility's operation and management to the private sector, once it has been delivered under the PFI contract. The public sector reduces its role to an enabler and facilitator of public services, while the private sector contractor bears the responsibility for the actual delivery of the service to the public. This approach is more likely to emphasise the strengths and “core business” areas of each partner and may include the devotion of more resources to the respective “core business.”¹¹⁵ The public sector's role is to concentrate on its duty to decide what service should be provided, leaving the private company to consider how it can be done best.¹¹⁶ PFI “fundamentally changes”¹¹⁷ the role of government departments and agencies from being owners and providers of assets into purchasers of services.¹¹⁸

The fundamental change in the delivery of public services described above involves redefining the state and its purposes. The public sector withdraws from

¹¹³ Freedland, “Public Law and Private Finance – Placing the private Finance Initiative in a Public Law Frame” (1998) *Public Law* p.306.

¹¹⁴ Lindrup/Godfrey, op.cit., note 1 of ch.1, para 181.

¹¹⁵ Dept. of Finance Nova Scotia, *Transferring Risk in Public/ Private Partnerships* (1997), para 1.4.3.

¹¹⁶ H.M. Treasury, op.cit., note 8, p.3.

¹¹⁷ Morrison/Owen, op.cit., note 71, p.2.

¹¹⁸ H.M. Treasury, Treasury Taskforce, op.cit., note 8, 3.01.

functions which were classically deemed to be of public nature.¹¹⁹ Moreover, the PPP approach supports the change from the hitherto predominant bureaucracy model of public administration to a managerial orientated approach.¹²⁰

By using private funds in addition to public expenditure, public sector authorities are enabled to undertake projects and provide services that otherwise might not be affordable or achievable due to insufficient public funds.¹²¹ Without adopting a PFI approach it might not have been possible to build the prisons at Bridgend and Fazakerley and the Skye bridge would have been opened at least five years later under a conventional procurement.¹²² Hence, private participation offers the potential to improve the efficiency of infrastructure services and relieve at the same time pressure of public budgets that had been previously the only source of infrastructure finance.

Public private partnerships have been referred to as being a key element in the government's strategy to improve the delivery of public services¹²³ after many years in which the public sector asset stock was allowed to deteriorate.¹²⁴ Improving one country's infrastructure is naturally a costly process. PFI offers the mechanism to deliver improved or new public facilities to the taxpayer without increasing public expenditure which had to be financed by tax increases.¹²⁵

Apart from improving the quality of public services in general, PFI is said to offer the advantage that the quality of services delivered to the final user is likely to improve.¹²⁶ This may be achieved through increased efficiency, better management

¹¹⁹ Thomas, "Private Finance Initiative - Government by contract" (1997) *European Public Law*, p.519.

¹²⁰ H.M. Treasury, op.cit., note 1, p.13, para 21.

¹²¹ The IPPR study *Building better Partnerships* (May 2001), characterises this argument in favour of PFI as "spurious," because all PFI projects are publicly funded and incur future liabilities for the Treasury. PFIs *per se* would not lead to "extra" schools or hospitals being built. See also: Arthur Andersen/LSE Enterprise, op.cit., note 73, para 3.50; PriceWaterhouseCoopers, *Attitudes to the Private Finance Initiative* (1999), p.3.

¹²² For other examples see: KPMG, *The Benefits of PFI* (1998), p.5.

¹²³ H.M. Treasury, op.cit., note 1, para 1 of the introduction.

¹²⁴ *Ibid.*, p.13.

¹²⁵ McLellan asserted that the electorate wants a considerable and rapid improvement in the quality and availability of public services but is not prepared to pay extra tax to fund that improvement, "Public Project Private Money" (1994) *New Builder/New Civil Engineer*, (PFI Supp. Jul), p.6.

¹²⁶ H.M. Treasury, op.cit., note 1, p.13 et.seq.

and more innovative solutions contributed by the private entrepreneur who is vested with comparatively more commercial expertise and experience than the public authority.¹²⁷

Furthermore, the private sector is perceived to put forward solutions that respond to customer demands, as its “profit motive” is considered a better incentive to carry out the project highly efficiently rather than the public sector's “service mission.” This includes that the private provider of a newly erected motorway bridge will seek to ensure that there is less congestion on the bridge because otherwise dissatisfied customers will try to use other ways to pass the river which would mean less revenue for the private entity. Hence, the commercial incentive to perform better is a continuing feature throughout the design, asset creation and operation of the activity in question.¹²⁸

The partnership approach inherent to the Private Finance Initiative encapsulates that projects delivered under the scheme are not only beneficial to the public sector.¹²⁹ PFI offers the private sector the prospect of gaining a predictable income stream over 25 or more years¹³⁰ and a closer long-term relationship with the public sector clients.¹³¹ PFI projects also offer the opportunity for accruing substantial profits when the private sector service provider manages to meet or even to exceed the standards agreed to in the main PFI contract. Some schemes give the provider the possibility of additional income generation opportunities which are not directly related to the services delivered, such as shopping facilities within hospital buildings.¹³²

In recent years, PFI has created such a magnitude of projects that knowledge of the Initiative has become a prerequisite for basic commercial activity. Companies that

¹²⁷ Fox/Tott, op.cit., note 5, para 1.2.6.

¹²⁸ H.M. Treasury, Treasury Taskforce, op.cit., note 8, para 3.25.

¹²⁹ A recent survey amongst senior decision makers revealed that three quarters of all respondents perceived PFI as beneficial to all those involved, PriceWaterhouseCoopers, op.cit., note 121, p.3.

¹³⁰ Arrowsmith (ed.), op.cit., note 24, para 1.034.

¹³¹ Private Finance Panel, op.cit., note 43, para 2.4.

¹³² Arrowsmith (ed.), op.cit., note 24, para 1.037.

took part in PFI projects gained a valuable set of skills, which make them more competitive in other industry sectors or abroad.¹³³ Hence, public private partnerships are not only a major boost to the construction industry from the viewpoint of the magnitude of projects and the sums involved, but they have also exerted a major impact on restructuring and modernising industry.¹³⁴ The partnership arrangements made it necessary for companies to adopt more efficient approaches as to the management of their consortium, the supply chains involved¹³⁵ and the long-term relationship with the public sector partner.¹³⁶ These innovative methods, which were further developed and refined in PFI projects, allowed private sector entities to perform more efficiently and, hence, be more competitive in other ventures.

2.2.5.3. Obstacles faced by the government

The obstacles that the British government had to face in pursuing and fostering PFI were addressed in the two “Bates Reports,” issued by Malcolm Bates on behalf of the Treasury in June 1997¹³⁷ and March 1999.¹³⁸ The reports identify several procedural and infrastructural areas that should be enhanced in order to achieve good value for taxpayers’ money. Four of the most pertinent and yet unsettled problem areas are discussed below together with the emerging solutions.

Industry consistently expresses two major concerns as regards to the Private Finance Initiative, which are partly interrelated. Bid costs remain too high and the contract award process is too slow.¹³⁹ Government departments have a genuine interest

¹³³ This goes in particular for the financial and legal advisor who could transfer their experience to other sectors and even to other countries interested in the PPP approach.

¹³⁴ McNamara, “The current Perspective of major United Kingdom Construction Companies on the Private Finance Initiative,” in: Stephenson (ed.), *Proceedings 13th ARCOM, September 1997*, p.578; PriceWaterhouseCoopers, op.cit., note 121, p.8.

¹³⁵ Cox/Harris/Parker, *Privatisation and supply chain management* (1998); Saunders, *Strategic Purchasing & Supply Chain Management* (1997).

¹³⁶ See Cox/ Townsend, *Strategic Procurement in Construction* (1998); Heal, “Construction Partnering: Good Faith in Theory and Practice” (1999) *Construction Law Journal*, p.167; H.M. Treasury, *Procurement Guidance No.4: Teamworking, Partnering and Incentives* (1997).

¹³⁷ H.M. Treasury, op.cit., note 10.

¹³⁸ H.M. Treasury, op.cit., note 18.

¹³⁹ Arthur Andersen/LSE Enterprise, op.cit., note 73, paras 3.35, 3.37.

to attract private sector companies to tender for PFI projects, since they need a sound industrial base from which to choose eligible providers.¹⁴⁰ The more firms are able to participate in the procedure leading to the award of the project, the more competition will induce not only a more preferential overall price but also a greater variety of possible solutions. This basic procurement rule that competition between the prospective suppliers induce a greater choice of variant tenders is pertinent in complex PFI projects. In those cases, the authority aims to achieve a variety of proposals concerning the parameters of financing, designing and operating. The multitude of parameters to be considered in the award process distinguishes a PFI from conventional procurement and provokes lengthy negotiations and ultimately high tendering costs for interested private companies.

The first Bates Reports made a number of recommendations to decrease the length of the negotiations and consequently the bidding costs for PFIs, including the use of standardised documents,¹⁴¹ the early limitation, that is “short-listing,” of the bidders to a maximum of four, and the removal of legal uncertainties.¹⁴²

In response to the recommendations, the Treasury commenced to publish standardisation documents for PFI contracts in general and a number of sector specific standardisation documents such as for IT contracts, contracts of local governments, defence related contracts and contracts for health projects.¹⁴³ It is hoped that by establishing sets of standard contract conditions and the standardisation of tender documents, legal fees and other costs may be reduced, as will the time spent negotiating with a preferred bidder.¹⁴⁴

The standardisation documents, which are drawn up from experience gained with past contracts, provide the various building blocks of a PFI agreement. They include

¹⁴⁰ Turpin, *Government Procurement and Contracts*, p.153.

¹⁴¹ H.M. Treasury, *op.cit.* note 10, p.11.

¹⁴² H.M. Treasury, *op.cit.* note 10, p.22.

¹⁴³ See note 17.

¹⁴⁴ *Committee of Public Accounts, op.cit., note 70, para 8; A typical PFI procurement procedure is likely to take about 15-18 months depending on the size, novelty and complexity of the individual project.*

inter alia service provision, pricing and payment mechanisms to “promote a common understanding of what risks are included in a statutory PFI contract; to allow consistency of approach..., and to reduce the cost of negotiation.”¹⁴⁵

The second means to reducing proposal costs, the early reduction in the number of bidders, appears to stand in contradiction to the essential procurement requirement of competition. Conversely, this reduction of candidates invariably suits both sides of a PFI transaction as the establishment of a “preferred bidder status” avoids incurring of substantial expense

Apart from streamlining the procurement process, the first Bates Report held that it is of utmost importance to remove legal uncertainties especially regarding NHS Trusts and local governments.¹⁴⁶ Bates identified especially the uncertainties surrounding the question of whether local authorities had the statutory powers, *vires*, of entering PFI agreements as a major obstacle to progressing the PFI scheme. The amended Local Government Act¹⁴⁷ protects now contractors and financiers from a PFI contract being void, which is the usual consequence of an *ultra vires* contract.¹⁴⁸

Another concern highlighted in the first Bates Report and a major source of delay was the compulsory “universal testing” of projects through central government agencies in the late stages of the project.¹⁴⁹ This requirement has been abolished¹⁵⁰ and now the Treasury Taskforce signs off the commercial viability of significant projects before the procurement process commences, reducing the transaction costs for bidders.¹⁵¹ Additionally, the Treasury has given written assurance that funding for contracts by central government departments will not be cut after signature of

¹⁴⁵ H.M. Treasury, op.cit. note 10, Introduction, I.B.

¹⁴⁶ H.M. Treasury, op.cit., note 10, para 22.

¹⁴⁷ Cf. the Local Government (Contracts) Act 1997.

¹⁴⁸ For a detailed account of the *ultra vires* issue: Arrowsmith (ed.), op.cit., note 24, paras 5.121-5.134.

¹⁴⁹ H.M. Treasury, op.cit., note 10, para 4.

¹⁵⁰ See for the exemption where central government funds are involved: Arrowsmith (ed.), op.cit., note 24, paras 5.106-5.120.

¹⁵¹ H.M. Treasury, Treasury Taskforce, op.cit., note 8, paras 2.04-2.06.

contracts.¹⁵²

Despite the improvements made to the PFI procurement process over the last years, recent surveys show that industries still consider the financial implications of tendering for a PFI scheme as too high and the bidding process as such as too onerous.¹⁵³

PFI projects are difficult to structure for government departments due to various reasons. Firstly, there is the problem of how to draw up the project specifications, which is of crucial importance for the quality of proposals received. The specifications, sometimes consisting of two documents the *user brief* and the *output service specification*, should not be too prescriptive about the means by which the requirements will be met.¹⁵⁴ Exceptions to this rule may be only permissible in situations of operational constraints or existing policies, including building materials to be used, total gross or net floor space to be delivered.¹⁵⁵ There is a danger of being over-specific for this could stifle innovative bids and proposals.¹⁵⁶ Bidders should, therefore, be given utmost flexibility but within the context of clear high-level service-based objectives which are fully defined in the specification.

Secondly, it has turned out to be rather difficult for procuring authorities to persuade firms to accept the transfer of a reasonable portion of risk.¹⁵⁷ There have been instances where the public sector has attempted to transfer risk to the private sector that is beyond its control, as in the example of transferring the volume risk to the private prison operator.

Finally, there may be pressures to re-negotiate PFI contracts where they do not turn out to be profitable enough for the private contractor to reimburse its investment,

¹⁵² *Ibid.*, para 4.07 for the approval procedure.

¹⁵³ Arthur Andersen/LSE Enterprise, *op.cit.*, note 73, paras 3.35; PriceWaterhouseCoopers, *op.cit.*, note 121, p.9; McNamara, *op.cit.*, note 134.

¹⁵⁴ H.M. Treasury, *Private Finance Panel*, Practical Guidance to the Private Finance Initiative - Writing an output specification (1996); *4Ps*, Output Specification in PFI Project (1999).

¹⁵⁵ H.M. Treasury, *Private Finance Panel*, *op.cit.*, note 46, p.9.

¹⁵⁶ H.M. Treasury, *PFI: Guidelines for smoothing the procurement process*, No.6 (1996).

¹⁵⁷ CBI, *op.cit.* note 98, p.17; Arrowsmith (ed.), *op.cit.*, note 24, para 2.035.

such as the Channel Tunnel. The same scenario is thinkable vice versa that the public sector is tempted to re-negotiate the agreement, if the private contractor is gaining excessive profits. The demand to re-negotiate and to adjust the agreed contractual terms to changed economic circumstances is likely to occur in the course of PFI schemes, because of the relatively long duration of the contract which invariably implies uncertainty about further viability.

Another reason for criticism is the poor regulatory basis of PFI which is not based on a single “PFI law” but many different statutes¹⁵⁸ forming the foundation for PFI in each sector, such as the London Regional Transport Act 1996. These are accompanied by a series of general guidance notes, policy statements, technical notes and case studies issued by the Treasury.¹⁵⁹ In view of the wide range of deals which only a few years ago would have been inconceivable, it is perceived as obvious that a single piece of legislation is needed to confirm that all types of public bodies have power to enter into PFI agreements. The related De-Regulation and Contracting Out Act 1994 may serve as a pattern for this type of “omnibus” legislation.¹⁶⁰ One result of the absence of a clear regulatory or constitutional¹⁶¹ basis had been unclear responsibilities between involved governmental authorities¹⁶² that cause prolonged and lastly more costly proceedings.

A distinct problem from regulating the procurement process and the settled *vires* issue is the question of how to regulate the newly created entities delivering services to the public. Public private partnerships are delivered within the policy context of deregulation and effectively blur the classical dividing line between public and private sector.¹⁶³ This context has repercussions for companies established under such

¹⁵⁸ Read, "Procurement of PFI contracts: Part 1," (1996) *J.L.S.S.*, p.188.

¹⁵⁹ Cf. H.M. Treasury, op.cit., note 8, Annex "Other relevant Publications."

¹⁶⁰ Editorial, "Legislation for the PFI," (1997) *Construction Law*, p.173.

¹⁶¹ Cf. Freedland, op.cit., note 113.

¹⁶² H.M. Treasury, op.cit. note 10, p.4.

¹⁶³ Bailey, op.cit., note 54, p.138

agreements, since it appears questionable whether they are accountable to the public¹⁶⁴ and subject to public law constraints, such as the procurement Regulations¹⁶⁵ or the human rights act, for the reason that they are delivering services to the public.¹⁶⁶

Furthermore, PFI deals are resource-intensive and require public and private sector negotiators to make expert judgments on a new and inherently complex web of commercial issues. At the heart of PFI lies a fundamental change in perspective. The public sector is no longer merely purchasing and owning assets but it is becoming “intelligent purchaser of long term services.”¹⁶⁷ On the side of the public sector, PFI requires no less than a radical change of culture. Public sector servants who operated to date in accordance with rules and rigid procedures are now supposed to negotiate deals with the private sector.¹⁶⁸ Hence, the public sector's “learning lessons” have to provide civil servants with training¹⁶⁹ in areas of project scoping, management and finance and elementary negotiation skills.¹⁷⁰ This learning process is likely to require substantial time as 95% of local councils responding to survey in 1998¹⁷¹ felt that they require greater understanding of PFI with 92% needing to improve their knowledge of the private finance market generally.¹⁷²

In comparison with a conventional supply contract, the PFI is also of substantial longer duration. For instance, the NIRS2 is for a term of seven years, while the Croydon Tramlink is contracted for 99 years. A long-term contract reduces the competitive pressure on the supplier to cut down costs and enhance quality in order not to lose the contract. This effect can be minimised by the use of performance

¹⁶⁴ H.M. Treasury, *op.cit.*, note 1, p.36.

¹⁶⁵ For the application of the procurement rules to joint venture companies: Arrowsmith (ed.) *op.cit.*, note 24, para 8.012.

¹⁶⁶ This is discussed below in section 10.2.4.

¹⁶⁷ H.M. Treasury, *op.cit.* note 10, p.5.

¹⁶⁸ Bailey, *op.cit.*, note 54, p.138.

¹⁶⁹ “Skill management” H.M. Treasury, *op.cit.*, note 1, p.28.

¹⁷⁰ NAO/ DETR, *op.cit.*, note 40, at para 58.

¹⁷¹ Commissioned by the Local Government Management Board and the DETR (7 October 1998).

¹⁷² These results are mirrored in a survey amongst senior private sector decision makers, who were not very confident that the public sector was making best use of its skills, cf. PriceWaterhouseCoopers, *op.cit.*, note 1211, pp.2, 4.

improvement measures and incentives in the contractual agreements, in particular, in the payment structure.

The performance measures have to be carefully designed, closely monitored, and, if appropriate, vigorously enforced in order not to undermine the agreed allocation of risks.¹⁷³ It is not compatible with PFI theory that despite the transfer of the risk of late delivery to the private sector provider, government departments have to cope with the consequences when new systems arrive late or fail,¹⁷⁴ such as the passport agency's IT system¹⁷⁵ or the NIRS2 project.¹⁷⁶

With respect to the enforcement of contractual terms, experience has shown that there is not only a gap between PFI an theory and practice but also a clash of paradigms. On the one hand, the authority has to take a vigorous stance in enforcing the rights of the taxpayers under the project agreement to ensure value of money. Without claiming the agreed financial penalties and possible compensations from the failing private contractor, risk has not been fully transferred and value for money is jeopardised.¹⁷⁷ On the other hand, enforcing the risk allocation vigorously arguably prejudices the partnership relationship which was established *inter alia* to adopt a less adversarial approach to the resolution of conflicts.¹⁷⁸

2.3. Types of private finance projects

2.3.1. PFI specific differentiation

Three types of private finance projects have to be distinguished. These are financially free standing projects, joint ventures between private and public sector and

¹⁷³ Select Committee on Public Accounts, *Getting better value for money from the Private Finance Initiative 23rd Report* (1999), para 19.

¹⁷⁴ "IT: Suppliers to avoid public sector deals" *Financial Times*, March 25, 1999.

¹⁷⁵ Public Finance (October 29, 1999), p.6.

¹⁷⁶ In the case of the NIRS2 project, the Treasury refrained from claiming more than £4.1 million, although the Contributions Agency have incurred nearly 316 million in irrecoverable costs, *Financial Times*, March 21, 2000; for a detailed report on this project see: Select Committee on Public Accounts, *Delays to the new National Insurance Recording System, 22nd Report* (June 1999).

¹⁷⁷ Select Committee on Public Accounts, op.cit., note 173, para 20.

¹⁷⁸ Cox/Thompson, *Contracting for Business Success* (1998), p.29; Trepte, "Partnering: Political Correctness or False Modesty?" (1993) *ECLR*, p.205.

services sold to the public sector.¹⁷⁹

2.3.1.1. Financially free standing projects

The rationale of financially free standing projects is that the private sector undertakes a project on the basis that the incurred costs will be entirely remunerated through charges for the services delivered to the final or end user.¹⁸⁰ The public sector's role is limited to “enabling” the project to go ahead,¹⁸¹ including activities such as the initial planning, the licensing, the awarding of works concessions, and providing ancillary works or assisting with statutory procedures.¹⁸² Typically, such contracts are of long term nature, meaning 20-25 years, and the assets are transferred to public ownership at the end of that period.¹⁸³

The most illustrative example for a financially free standing project is a newly erected toll bridge, that is planned and awarded by a public authority, whereas designed, financed and built by a private sector company or consortium. The latter recovers its costs from the final private user by levying toll over a stipulated period.

2.3.1.2. Joint ventures

Joint ventures are projects to which both the public and the private sector contribute and whose returns they share. The projects' costs are met by public funds and by other, meaning private, sources of income.¹⁸⁴ The private sector bears the responsibility for development and overall control of the operation in which the public sector retains a continuing interest.

The public sector contribution assures broader social benefits that cannot be entirely captured in commercial revenue,¹⁸⁵ such as reduced road congestion¹⁸⁶ or, generally speaking, enhanced quality of life. The public sector contribution to a joint

¹⁷⁹ H.M. Treasury, op.cit., note 7.

¹⁸⁰ Arrowsmith (ed.), op.cit., note 24, para 1.012.

¹⁸¹ Gilbert, *The enabling State* (1990).

¹⁸² H.M. Treasury, op.cit., note 8, p.1.

¹⁸³ Digings/Bennett, op.cit., note 2 of ch.1, para D2.3 (1992).

¹⁸⁴ H.M. Treasury, Private Finance Panel, op.cit., note 4, para 1.4.

¹⁸⁵ H.M. Treasury, op.cit., note 8, p.2.

¹⁸⁶ Digings/Bennett, op.cit., note 2 of ch.1, D2.4.

venture may comprise grants, loans, existing assets, such as land, or ancillary or associated works. Concrete examples are infrastructure projects like various town centre regeneration schemes, urban light railway projects, such as the Croydon Tramlink, Dockland Railway Extension and the Channel Tunnel Rail Link.

2.3.1.3. Services sold to the public sector

Services are considered sold to the public sector when their costs are partly or entirely met by charges from the private sector service provider to the public sector body which lets the contract. The public authority is in effect contracting out the service provision or buying-in the service in question.¹⁸⁷

In comparison with the classical “contracting out,” as defined above, the “services sold to the public sector” method has the distinct feature that the service provision depends upon the provision of dedicated capital assets, such as purpose-built plants or buildings, by the private sector contractor. Agreements for private contractors to design, build, finance and operate prisons or IT systems are examples of services sold to the public sector. As in the case of financially free standing projects, such contracts are typically of long term nature.¹⁸⁸ Ownership of assets may or may not transfer to the public sector at the end of the period.

2.3.2. General differentiation

Another method to differentiate concession-type arrangements, which is applied on international level,¹⁸⁹ is to identify the involvement of the concessionaire in the individual phases of the arrangement. This differentiation results in schemes as “build operate transfer” (BOT),¹⁹⁰ “build operate own transfer” (BOOT), “build own operate” (BOO), “design build operate maintain” (DBOM), “design build finance operate”

¹⁸⁷ Freedland, op.cit., note 113, at p.290.

¹⁸⁸ Digings/Bennett, op.cit., note 2 of ch.1, D2.4.

¹⁸⁹ Guislain/Kerf, “Concessions- The Way to Privatize Infrastructure Sector Monopolies,” *Public Policy for the Private Sector* (The World Bank), Oct. 1995.

¹⁹⁰ Wallace, “Emerging Host Country Legal Framework for Privately Financed Infrastructure Projects (BOT): The Procurement Elements,” paper presented at “Public Procurement: Global Revolution” Aberystwyth 1997; UNIDO, *BOT Guidelines* (1996); Walker/ Smith, *Privatized Infrastructure – the BOT approach* (1999).

(DBFO), or “design construct manage finance” (DCMF).¹⁹¹

One principal difference between these contract types is the legal ownership of the assets build and financed by the private sector. In some instances, the ownership remains private until their transfer to the state at the end of the concession term, such as in many BOT/ BOOT schemes.¹⁹² In other circumstances the assets are owned by the public from the moment they are built, as in traditional French concessions, the private operator retaining full commercial control over them until the end of the concession period. Finally, under BOO schemes, the assets remain in private ownership.

In accordance with this internationally adopted differentiation, PFI projects may be classified mostly as variations of the “humble concession”¹⁹³ scheme apart from the feature that they generally¹⁹⁴ not involve the transfer of the assets to public ownership subsequent to the expiration of the concession term.¹⁹⁵ Contrary to the outlined concession approaches, the emphasis of PFI is away from sole funding and towards an increased involvement of the contractor in every stage of the project. Hence, the private sector contractor will in most cases be involved in the design and operation of a capital asset, since.¹⁹⁶

2.4. Corporate and contractual structure of PFI projects

In the previous sections, the major contractual parties were referred to as “public sector authority” and “private sector company,” which are mere umbrella terms. The purpose of the following section is to introduce the two major parties to a typical public private partnership project conducted under the Private Finance Initiative and to outline the complex contractual relationship between them.

¹⁹¹ Cf. Pertchik, "The Build-Operate and Transfer Approach to Infrastructure Development in Mexico" (1995) *P.P.L.R.* p.169.

¹⁹² *Ibid.*, at p.170.

¹⁹³ Vinter, *Project Finance* (1998), p.240.

¹⁹⁴ Notable exceptions are prison and motorway projects.

¹⁹⁵ PFI projects will be classified as DCMF, DBFO or DBOM schemes rather than BOT, BOO or BOOT.

¹⁹⁶ H.M. Treasury, *op.cit.*, note 8, p.12-13.

2.4.1. *Dramatis personae*

Public private partnerships involve at least two partners, a public body and a private entity, usually in a contractual relationship. Besides these two major players, there are a number of other actors involved in a typical PFI arrangement, such as the project funders and the major subcontractors. The following section deals with the identity and the specific contribution of each partner to a typical PFI project and describes their roles and objectives.

2.4.1.1. *Public sector body*

Under the umbrella term of “public sector bodies,” a multitude of government departments and agencies on all horizontal levels of government can be identified. In some instances, they have delivered PFI projects across departmental boundaries.¹⁹⁷ The hierarchical level of government department or agency representing the public sector depends on the sector concerned. School projects are advertised by local authorities, whilst defence contractors will have to deal directly with the Ministry of Defence and PFI projects in the health sector are normally advertised by National Health Service Trusts.

In addition to the awarding authority, a typical PFI project will also attract the attention of the responsible government minister and, in some cases, the Treasury.¹⁹⁸ Considering the plethora of departments and agencies involved in signing PFI projects, it does not seem possible to view the public sector as one entity. This has negative implications for learning lessons from previous projects, since each department has to go through a similar learning process, gradually acquiring a level of expertise at considerable costs.¹⁹⁹ Hence, although the public sector is involved in a

¹⁹⁷ Arrowsmith (ed.), op.cit., note 24, para 3.005.

¹⁹⁸ In the contract for the new Dartford and Gravesham hospital, the responsible health authority, the NHS Executive Regional Office, the NHS Headquarters and the H.M. Treasury got involved, NAO, op.cit., note 44, para 1.19, figure 2.

¹⁹⁹ Arrowsmith (ed.), op.cit., note 24, para 3.008.

great number of PFI schemes, it is not able to realise the full synergies.²⁰⁰

Irrespective of the individual governmental department or agency involved, the role of the public sector authority in a PFI deal is to enable the project and to manage its procurement process. Where appropriate, the contracting authority shall guard the interests of the users and the customers by ensuring during the operation phase that the agreed quality standards are satisfied.²⁰¹

The three distinct phases of a typical PFI project require distinct sets of skill from the procuring authority such as defining the need in output terms, procuring and negotiating a contract and then managing the project including monitoring and enforcing the safety, quality and performance standards.²⁰² The main objectives for the public sector to embark upon PFI projects are to achieve value for money and to allocate each category of risk with the partner best able to manage it. Thus, it is sought to complete the asset to time, cost and quality.²⁰³

2.4.1.2. Private sector

The role of the private sector contractor, on the other side, is characterised by the delivery of a wide range of works, services and products, which are part of the overall PFI business delivered to the public. Such an agreement requires a diversity of skills and experiences.²⁰⁴

Firstly, the private sector company has to finance the project up-front, since the revenue stream from the government department only commences on delivery of the services to the specified standards. Apart from pre-financing the project, the private sector contractor has to deliver the design and the actual construction of the asset and

²⁰⁰ This issue has been mentioned in the first Bates report (op.cit., note 10, para 5). The Treasury sought to minimise its effects by publishing guidance notes. Strengthening the bargaining power of the public sector has been also a major theme of the Gershon Report, leading to the recommendations to establish a central procurement organisation (Office of Government Commerce), H.M. Treasury, *Review of Civil Procurement in Central Government by Peter Gershon* (1999).

²⁰¹ CIPFA, *The Private Finance Initiative* (1997), p.7 et.seq.

²⁰² H.M. Treasury, op.cit., note 1, p.11.

²⁰³ Fox/Tott, op.cit., note 5, pp.21-22.

²⁰⁴ Morrison/Owen, op.cit., note 71, para 1.5.2.

its management and maintenance.²⁰⁵

To satisfy the diverse requirements, private sector companies operating in different markets usually join together and establish consortia when bidding for PFI contracts. A consortium typically comprises construction companies and developers, manufacturers, facilities management provider, bankers and insurers and financial or legal PFI advisers. In the late stages of the award process, the successful consortium, itself lacking a corporate structure, establishes or promotes a “special purpose vehicle” (SPV), in most instances a limited company,²⁰⁶ which then becomes party to the project agreement to be concluded with the contracting authority. The SPV is a mere shell company, especially established for the PFI project and, hence, its obligations and liabilities towards the government department should be matched by back-to-back liabilities and obligations of the sub-contractors to the SPV. The former consortium members will hold an interest in the project-specific SPV by way of shareholding, a loan made to the SPV, or a sub-contract.²⁰⁷

On winning the PFI contract, the SPV has to implement the agreement and ultimately ensure the long term growth of the business.²⁰⁸ The main goals for the private sector contractor are, therefore, to minimise bidding costs during the procurement phase, whilst maximising the profits arising from the scheme, by minimising *inter alia* their exposure to risk.²⁰⁹

Other private sector players are the financiers of the project, whose interests might deviate from those of the SPV, since their major aim is the protection of the investment made.²¹⁰ These are primarily the providers of the “senior debt,” such as

²⁰⁵ The operational duties of service providers in the operation phase of the project will normally be spelled out in detail, since these clauses serve as performance measure and can influence the payment stream of the private contractor. Cf. H.M. Principal Secretary of State for the Home Department, *Agecroft Prison Management Limited - Conditions of Contract for the Design, Construction, Management and Financing of a Custodial Service at Agecroft, Salford* (1998), part III, IV.

²⁰⁶ Arrowsmith (ed.), op.cit., note 24, para 3.011.

²⁰⁷ Morrison/Owen, op.cit., note 71, para 4.1 et. seq.

²⁰⁸ Lindrup/Godfrey, op.cit., note 1 of ch.1, para 66.

²⁰⁹ Fox/Tott, op.cit., note 5, pp.29-30.

²¹⁰ On financing the PFI project see: Morrison/Owen, op.cit., note 71, chapter 4.

banks or other lending institutions, which may decide to syndicate their debt in sizeable projects.²¹¹

Apart from the debt provided by the senior lenders, the project is financed through equity provided by either active investors such as the shareholders of the SPV, or passive investors such as specialised PFI funds.²¹² Lending institutions and public sector authority share the interest to secure the continued existence of the project. Whilst the bank is interested to secure the revenue stream securing its debt, the authority will seek to ensure the delivery of the services to the public. Therefore, each of the parties will want the contractual option to step in the SPV's rights and obligations under the PFI contract and its sub-contracts if the SPV fails.²¹³

2.4.2. Contractual structure

The contracting authority and its private sector partners establish a complex contractual structure, which distinguishes public private partnerships from conventional bipartite procurement contracts. The backbone of the PFI project, defining the partnership, is the multi-faceted project agreement between authority and the SPV.²¹⁴ Most PFI project agreements will contain *inter alia* clauses dealing with the duration of the contract, the transfer of the asset at the end of the project term,²¹⁵ the payment mechanism, the termination of the contract and indemnities and insurance issue.²¹⁶ Furthermore, the authority will want to enter into a direct agreement with the project funder. The direct agreement contains *inter alia* the right of the funder and the authority to step-in the rights and obligations of a failing (sub-) contractor and ultimately to replace the (sub-) contractor jeopardising the success of the project.²¹⁷

The SPV will neither perform the work or services itself nor will it be prepared to

²¹¹ Arrowsmith (ed.), op.cit., note 24, para 3.021.

²¹² The ratio between debt and equity in a typical PFI project is about 85/15.

²¹³ Step-in rights are looked at more closely in chapter 11.

²¹⁴ Arrowsmith (ed.), op.cit., note 24, para 3.050.

²¹⁵ The asset is transferred either to the authority or to a new supplier.

²¹⁶ For a very detailed account of the contractual clauses see: H.M. Treasury, Treasury Taskforce, op.cit., note 17 (PFI Contracts).

²¹⁷ See below chapter 11.

accept the risks attached to the performance of the contractual obligations,²¹⁸ but will pass on both risk and responsibility for the actual works and services to sub-contractors.²¹⁹ The SPV will conclude a construction agreement with the major construction contractor,²²⁰ which will be a fixed price, time certain turnkey contract under which the contractor accepts the related construction risks.²²¹ The major construction contractor will then enter into agreements with sub-contractors guaranteeing the supply of equipment and ancillary works. Apart from the construction agreement there will be at least one further contractual relationship between the SPV and sub-contractors dealing with the operation and maintenance of the asset.

A third level of agreements is formed by contracts related to the finance of the asset and the internal organisation of the SPV. The project will be normally funded by a mix of equity and debt, both of which are backed up by funding agreements with the debt funders and equity providers.²²² The relationship between the SPV and its active investors will be regulated in a shareholder agreement,²²³ setting out *inter alia* the legal rights and liabilities of its members, the management and voting arrangement and the profit distribution.

²¹⁸ However, there are exceptions from this typical contractual structure. For example, IT projects are often performed by the SPV itself.

²¹⁹ Morrison/ Owen, op.cit., note 71, para 4.8.

²²⁰ In addition, the SPV might want to conclude a direct agreement with the parent of the construction company to guarantee the performance of the construction contract. The same applies to the operating and maintenance agreement, which may be backed up by a performance guarantee too. Seeking such performance guarantees from the parent companies was one key learning lesson from the first prison contracts, H.M. Treasury, Private Finance Panel/ H.M. Prison Service, op.cit., note 93, para 6.1.4.

²²¹ Lindrup/Godfrey, op.cit., note 1 of ch.1, para 226.

²²² See on the funding agreement: Fox/Tott, op.cit., note 5, chapter 8.

²²³ Arrowsmith (ed.), op.cit., note 24, para 3.065 et seq.

Chapter 3 The EU procurement rules

3.1. Introduction

As public authorities are using the PFI scheme for purchasing goods, works or services, most PFI projects are subject to these rules on public procurement laid down by the European Union in Council Directives¹ that have been implemented by the United Kingdom by way of statutory instruments (Regulations).² The Council Directives of the European Community can be regarded as one major stimulus towards the process of liberalising public purchasing world-wide, since it has been internationally used as pattern by many countries and organisations for modelling their procurement rules.

Chapter 3 will firstly map out in section 3.2. the economic objectives of regulating procurement on international and supra-national level. Section 3.3. will then introduce the legal framework of public procurement within which most PFIs have to be delivered. Finally, section 3.4. will describe why it is necessary to conduct further research into PFI procurement.

3.2. Economic objectives of regulated procurement

The rationale for regulating procurement on international level is that harmonising national rules and policies in this area is supposed to achieve substantial economic benefits by way of liberalising the domestic procurement markets. The importance of free markets as a method of gaining a higher level of productivity, income and employment and of reducing costs and prices is generally laid down in

¹ Council Directive ("Works Directive") 93/37/EEC (OJ [1993] L 199/p.54); Council Directive ("Services Directive") 92/50/EEC (OJ [1992] L 209/p.1); Council Directive ("Supply Directive") 93/36/EEC (OJ [1993] L 199/p.1); Council Directive ("Utilities Directive") 93/38/EEC (OJ [1993] L 199/p.84).

² Public Works Contracts Regulations ("Works Regulation"), S.I. 1991/2680, as am. by Public Supply Contracts Regulations 1995, S.I. 1995/201; Public Services Contracts Regulations 1993 ("Services Regulation"), S.I. 1993/3228, as amended by Public Supply Contracts Regulations 1995, S.I. 1995/201; Public Supply Contracts Regulations 1995 ("Supply Regulation"), S.I. 1995/201; Utilities Contracts Regulations 1996 ("Utilities Regulation"), S.I. 1996/2911.

Article 2 of the Treaty of Rome³ and is also embodied in the European Single Act of 1985. Opening up procurement markets, in particular, was pinned to the expectation that this would lead to increased competition between European companies, improved industrial efficiency and competitiveness of European companies in global markets and, finally, reduced purchasing costs of the public sector and utilities.⁴

Prior to 1992, Member States continued to use public purchasing as an instrument of their economic policies and kept much of their procurement closed to foreign competition despite the liberalisation objectives laid down in the EC-Treaty. The 1988 Cecchini Report described public sector markets in the EC12 as closed and generally uncompetitive. In the run-up to the Single Market, experts have attempted to estimate the financial implications of the continued closure of the Community's markets for public contracts. The report estimated the additional cost of non-realisation of the Common Market in this area to be some 21.5 billion ECU,⁵ equivalent to ½ per cent of total Community GDP.⁶ The “cost of non-Europe” was identified as a direct, serious threat to essential components of the Community's industrial potential.⁷

In view of these potential economic benefits, opening procurement market in establishing rules for procedures and remedies for public purchasing has been characterised as a major instrument for achieving the European Single Market.⁸ In the phase leading to the creation of this Single Market in 1992, the European Commission recognised in 1987 that total purchasing controlled by the public sector exceeded ECU 500 billion and amounted to 15% of the Community's gross domestic product.⁹ Nevertheless, in 1987 only 2% of supply contracts and 2% of public construction

³ “The Community shall have as its task [...] to promote throughout the Community a harmonious and balanced development of economic activities [...]”

⁴ European Commission, op.cit., note 10 of ch.1, para 1.13.

⁵ Cecchini, *The European Challenge: 1992. The Benefits of a Single Market*, p.18.

⁶ W.S. Atkins Management Consultants, *The Cost of Non-Europe in Public Procurement*, Vol.5A, p.54.

⁷ European Commission, *Public Supply Contracts – Conclusions and Perspectives*, Communication to the Council COM(84) 717 final, p.4.

⁸ European Commission, *Economics of 1992*, p.17.

⁹ Cecchini, op.cit., note 5, p.16.

contracts had been awarded to firms from other Member States, compared to levels for private sector purchasing of between 25% and 45%.¹⁰

In theory it is assumed that providing foreign competitors with access to the traditionally closed procurement markets is likely to improve overall economic welfare by having at least three distinctive effects, namely the “static trade effect,” the “competition effect” and the “restructuring effect.”¹¹ According to the competition effect, open procurement markets allow foreign companies to enter the market and hence to align the prices of domestic suppliers with those of the most competitive foreign firm. As a result, authorities are provided with the opportunity to realise savings when buying at lower prices from the most competitive, possibly foreign, suppliers in the Community. This effect is referred to as “static trade effect.”

Furthermore it is argued that industries have to re-organise themselves under the pressure of new competitive conditions via joint ventures, mergers and acquisitions to create global players capable of competing with companies from the United States and Asia in world markets. This reorganisation of certain strategic industries is capable of effecting economies of scale which will be passed on in the form of lower prices.¹²

The evaluation of the economic implications of liberalising the Community’s procurement markets made prior to the creation of the Single Market and the underlying theoretical considerations appear over-optimistic from today’s perspective,¹³ since the actual “results still fall far short of the total potential benefits.”¹⁴ Even though the overall figure of import penetration increased from 2% to 10%¹⁵ in 1994 and the public sector purchasing amounted to ECU 721 Billion,

¹⁰ Emerson, *The Economics of 1992*, p.48.

¹¹ Cecchini, op.cit., note 5, p.17.

¹² “Restructuring effect.”

¹³ For a critical account: Arrowsmith, “The Way Forward or a wrong Turning? An Assessment of European Community Policy on Public Procurement in Light of the Commission's Green Paper” (1997) *European Public Law*, p.389.

¹⁴ European Commission, op.cit., note 10 of ch.1, para 3.6.

¹⁵ European Commission, *Commission Staff Working Paper- The 1996 Single Market Review* (1996), p.46-48.

equalling 11.5% of the GDP,¹⁶ the November 1997 Single Market Scoreboard¹⁷ confirmed that public procurement is one of the key areas of the Single Market where results do not yet meet expectations due to a variety of unsettled problems. There remain inherent structural obstacles like different national standards in certain product areas and the phenomenon that suppliers tend not to pass on their savings but rather price to the different markets by undercutting their domestic competitors just to the slightest extent necessary.¹⁸ It is not surprising that “there is as yet little evidence of substantial savings to public purchasing authorities.”¹⁹

The 1997 Scoreboard also revealed that public procurement is one of the areas where the implementation deficit is the greatest, with only 55.6% of the Directives correctly implemented in all Member States. In face of failing or inadequate transposition of the Directives it appears as yet too premature for rendering a conclusive judgement on the economic effectiveness of the European procurement rules.

3.3. Legal framework

European Public Procurement law is based on three pillars, namely certain provisions in the E.C. Treaty, two sets of Council Directives and four fundamental principles which can be derived from the jurisprudence of the European Court of Justice.

3.3.1. Treaty provisions

The EEC Treaty of 1957 (Treaty of Rome) was primarily concerned with creating a single market in Europe by setting out broad general principles such as the free movement of goods, services, labour and capital (“the four freedoms”) within the Community’s territory.²⁰ The Treaty, which was recently extensively modified and

¹⁶ *Ibid.*, p.45.

¹⁷ European Commission, *The Single Market Scoreboard* (1997).

¹⁸ Bohann/Redonnet, op.cit., note 4 of ch.2, p.169.

¹⁹ European Commission, op.cit. note 15, p.48.

²⁰ For a more detailed coverage of the “four freedoms” see Wyatt/Dashwood, *European Community Law* (1993), Part III; Craig/De Búrca, *E.U. Law* (1998), chapter 8.

renamed the E.C. Treaty by the Treaty on European Union (Maastricht Treaty), makes no expressive mention of public contracts.²¹ Nevertheless, a number of its more general provisions concerned with free movement are pertinent to public procurement. They institute and guarantee the proper operation of the Single Market. The effect of these general obligations under the Treaty of Rome is, effectively, to render any conduct by regulated entities unlawful which discriminates, directly or indirectly,²² against contractors or products from other Member States²³ and which obstructs the realisation of the European single market.

In the context of public contracts, the E.C. Treaty is, firstly, of considerable importance for those contracts, which do not come within the ambit of the more detailed procurement Directives. The Articles of the E.C. Treaty outlined below are applicable as sole legal source to small contracts not exceeding the value threshold of the Directives and, more pertinent in the context of PFI, to contracts granting service concessions.²⁴ Secondly, the E.C. Treaty is applicable, albeit on a supplementary basis, to contracts that come within the scope of the Directives.²⁵

Therefore, irrespective of whether the individual public contract is fully, partially²⁶ or not subject to the regime of the procurement Directives, the awarding authority has at all events to comply with the basic rules of the E.C. Treaty.

3.3.1.1. Article 12

Article 12 E.C. Treaty now contains the basic rule prohibiting any discrimination on grounds of nationality which was formerly included in Article 6. This rule does not only aim at overt discriminations but prohibits further all kinds of indirect

²¹ With the exception of Art.130f(2) concerned with supporting co-operation among undertakings, research centres and universities by opening up national public contracts.

²² After the landmark decision in “Cassis de Dijon,” Case 120/78 *Rewe Zentral AG v. Bundesmonopolverwaltung für Branntwein* [1979] E.C.R. 649, even non-discriminatory measures can be held not reconcilable with Article 28.

²³ Arrowsmith, “An Overview of EC Policy on Public Procurement: Current Position and Future Prospects” (1992) *P.P.L.R.* p.30.

²⁴ European Commission, *Draft Commission interpretative communication on concessions under Community law on public contracts* (1999).

²⁵ Prieß, op.cit., note 2 of ch.1, p.64.

²⁶ “Lightly regulated contacts” such as concessions, see below section 7.2.6.

discrimination, which, irrespective of the connecting factor for the discrimination in question, have as their de facto effect an unequal treatment of citizens of other Member States.²⁷

In the context of public procurement it is therefore not possible to exclude bidders from other Member States from the contract award procedure or to discriminate against them on the grounds that they are non-nationals. The European Court of Justice ruled that the imposition of certain conditions²⁸ “which could be satisfied only by tenderers from the State concerned or indeed that bidders from other Member States would have difficulty in complying with”²⁹ are not compatible with Article 12. However, Article 12 is of autonomous application only in situations governed by Community law for which the Treaty does not provide any specific rules on non-discrimination.³⁰

3.3.1.2. Article 28

Articles 28 of the Community Treaty prohibits quantitative restrictions on the free import and export (“movement”) of goods and all measures having equivalent effect, between Member States. Measures have, according to the “Dassonville Rule,”³¹ equivalent effect for the purposes of Article 28 when they are capable of hindering directly or indirectly, actually or potentially, intra-Community trade. The Dassonville Rule is subject to a rule of reason as developed by the ECJ in the *Cassis de Dijon* case.³² Pursuant this rule of reason, certain measures, though within the Dassonville formula, will not breach Article 28 if they are necessary to satisfy mandatory requirements. A further derogation from the general rule of “free movement of goods” can be found in Article 30 and allows for considerations of health and public policy.

²⁷ Prieß, op.cit., note 2 of ch.1, p.6.

²⁸ For example the employment of long-term unemployed persons.

²⁹ Case 31/87 *Gebroeders Beentjes v. The Netherlands* [1988] E.C.R. 4653, at para 30 of the judgment.

³⁰ Case C-10/90 *Masgio v. Bundesknappschaft* [1991] E.C.R. I-1119.

³¹ Case 8/74 *Procureur du Roi v. Dassonville* [1974] E.C.R. 837.

³² Case 120/78 *Rewe Zentral AG v. Bundesmonopolverwaltung für Branntwein* [1979] E.C.R. 649.

In the context of public procurement Article 28 is invoked not only when certain measures affect the domestic market as a whole, but also where only the access to the government market is restricted.³³ It has to be further noted that Article 28 does not only apply to supply contracts, but any contract such as for the performance of works or non-construction services.³⁴

The scope of Article 28 includes, firstly, measures which directly discriminate between national products and those from other Member States. Government departments are thus precluded from purchasing only national products, such as cars,³⁵ or to require that national products are used as far as possible.³⁶ In addition, the Court of Justice held that the pursuance of procurement policies granting preferences to undertakings operating in underdeveloped regions³⁷ is not reconcilable with Article 28 since those policies discriminate *inter alia* against imported products.³⁸

Secondly, Article 28 prohibits measures which are indistinctly applicable to domestic and imported products but which have *de facto* the effect of favouring domestic products. Such indistinctly applicable measures are, for instance, national standards which apply to domestic and to foreign products but favour in practice domestic products, since only domestic firms are likely to manufacture their products in compliance with the national standard.³⁹

In applying the *Cassis de Dijon* principle, Article 28 bars thirdly certain measures which are neither directly nor indirectly discriminatory when they are related to the characteristics of the goods, such as safety standards. This principle precludes in the context of public procurement that contract specifications contain unduly restrictive

³³ Arrowsmith, *op.cit.*, note 2 of ch.1, p.79.

³⁴ Case 45/87 *Commission v. Ireland* “Dundalk” [1988] E.C.R. 4929, at para 17 of the judgment.

³⁵ Case C-263/85 *Commission v. Italy* [1991] E.C.R. I-2457.

³⁶ Case C-243/89 *Commission v. Denmark* “Storebaelt” [1993] E.C.R. I-3353.

³⁷ Case C-21/88 *Du Pont de Nemours Italiana v. Unita Sanitaria* [1990] E.C.R. 889.

³⁸ **Critical in so far: Stehmann/Fernandez Martin, “Product Market Integration v. Regional Cohesion in the Community” (1991) *E.L.Rev.* p.242.**

³⁹ Case 45/87 *Commission v. Ireland* “Dundalk” [1988] E.C.R. 4929.

product characteristics.⁴⁰ For example, the specification of a certain computer system was held to be unduly restrictive not for the reason of favouring national suppliers, but merely for the fact that providers of alternative products, which were also suitable for meeting the government's requirements, were thus excluded.⁴¹

3.3.1.3. Article 43 and Article 49

Article 43 abolishes restrictions on the freedom of establishment imposed on citizens of one Member State in the territory of another Member State. This freedom of establishment includes the right to take up and pursue activities as self-employed person, and to set up and manage undertakings on equal basis with nationals of the host state.⁴²

In the context of public procurement the freedom of establishment abolishes any restrictions on access to government contracts which affect the activities of non-nationals established in the Member State in question.

Article 49 secures the freedom of citizens to provide services on a temporary basis in another Member State, including persons wishing to participate in government contracts for services. Hence, Member States are precluded to reject bidders on the ground that they are not in the possession of an establishment permit.⁴³

Both, Article 43 and 49 prohibit measures discriminating directly or indirectly nationals from other Member States. When the Italian legislation required companies interested in contracts for the development of data processing systems for public authorities to be directly or indirectly in Italian public ownership, the Court of Justice held that both articles embody specific instances of the general principle of equal treatment. This principle prohibits not only direct discrimination by reason of

⁴⁰ Arrowsmith, op.cit., note 2 of ch.1, p.83.

⁴¹ Case C-353/93 *Commission v. The Netherlands* "UNIX" [1995] E.C.R. I-157.

⁴² Article 43, second paragraph; Case C-221/89, *Factortame* [1991] E.C.R. I-3905; Case 182/83 *Fearon* [1984] E.C.R. 3677.

⁴³ Case 76/81 *Transporoute et Travaux SA v. Ministere des traveaux public* [1982] E.C.R. 417.

nationality, but also all other indirect forms.⁴⁴ A piece of Italian legislation was challenged on the grounds of stipulating that awarding authorities must reserve 15 to 30% of public works to contractors located in the region where the works are to take place.⁴⁵ These provisions were held to be not compatible with Article 49 (the former Article 59) as they essentially favoured Italian firms which were much more likely to be active in the region concerned than companies from other Member States. Another form of indirect discrimination, which is not compatible with Article 49,⁴⁶ is the insistence of the authority to use local labour which makes it more difficult and more expensive for non-nationals to provide the works or services with their own work force.⁴⁷ As in the case of Article 28, the Treaty provisions on services catch genuinely non-discriminatory measures.⁴⁸

The E.C. Treaty provides in Article 55 a derogation from the above outlined principles of Article 43 and 49 in excluding such activities from the Articles' scope which "are connected, even occasionally, with the exercise of official authority." Albeit it is not entirely clear how this derogation affects public procurement,⁴⁹ the Court of Justice indicated that Article 55 should be interpreted narrowly⁵⁰ as encompassing only authorities which exercise actual judicial and legislative powers.⁵¹

3.3.1.4. Article 296

In the area of defence procurement, the E.C. Treaty provides a number of significant exemptions, which in view of most commentators means that the area is

⁴⁴ Case C-3/88 *Commission v. Italy* "Re Data Processing," [1989] E.C.R. 4035; [1991] 2 CMLR 115; this judgment was confirmed in the late Case 272/91, *Commission v. Italy* "Italian Lottery"/ "Lottomatica"[1992] E.C.R. I-3929 in the President's first order, with annotations: Arrowsmith, *A Guide to the Procurement Cases of the Court of Justice*, p.127; Giliam, (1992) *P.P.L.R.* p.160.

⁴⁵ Case C-360/89 *Commission v. Italy*, [1992] E.C.R. I-3401.

⁴⁶ Case C-243/89 *Commission v. Denmark* "Storebaelt" [1993] E.C.R. I-3353.

⁴⁷ Case C-113/89 *Rush Portuguesa v. Office national d'immigration* [1990] E.C.R. I-1417.

⁴⁸ Case C-384/93 *Alpine Investments* [1995] E.C.R. I-6097, at para 37-38 of the judgment.

⁴⁹ Arrowsmith, *op.cit.*, note 2 of ch.1, p.93.

⁵⁰ Case C-3/88 *Commission v. Italy* "Re Data Processing," [1989] E.C.R. 4035, para 13; Case 272/91, *Commission v. Italy* "Italian Lottery"/ "Lottomatica" [1992] E.C.R. I-3929.

⁵¹ Arrowsmith, *op.cit.*, note 2 of ch.1, p.93.

substantially excluded from the rules on the free movement of goods and services.⁵² Article 296 excludes measures relating to products of military nature from the realm of the Treaty and Article 297 includes an exemption for various exceptional circumstances, such as war. Furthermore, the free movement provisions of the Treaty provide for derogations on national security grounds, which allow security goals, such as to preserve domestic industries in strategic sectors, to be implemented through economic means.⁵³

3.3.2. E.C. Procurement Directives

From the outset, the European legislator was aware that an open market in procurement cannot be left solely to the general provisions of the Treaty and the jurisprudence of the Court of Justice.⁵⁴ The legislator was faced with a great diversity of procurement systems in Member States and with considerable differences in the organisation of the relevant markets and public authorities. For those reasons, the Council initially adopted two Directives in the area, one for the procurement of works in 1971 and in 1977 another one for the supplies of goods.⁵⁵ These can be viewed as the predecessors of the current public sector Directives as they regulated the purchases of traditional public bodies such as government departments, regional governments and local authorities, and certain other authorities of public nature.⁵⁶

These rules and their later amendments,⁵⁷ consisting of various legal instruments adopted between 1971 and 1980, resulted in a complex body of Community law. Alongside the complexity of the rules, their insufficient incorporation into national law of each Member State rendered it impossible to establish an internal market for

⁵² Trybus, *European defence procurement Regulation* (1999).

⁵³ Case 72/83 *Campus Oil v. Ministry for Industry and Energy* [1984] E.C.R. 2727.

⁵⁴ European Commission, *Public Procurement in the Community*, COM(86) 375 final, p.3.

⁵⁵ Council Directive 71/305/EEC (Works), [1971] O.J. L185/1; Council Directive 77/62/EEC (Supplies), [1977] O.J. L13/1. For details of these original Directives cf. Weiss, op.cit. note 2 of ch.1, ch.4.

⁵⁶ Arrowsmith, op.cit., note 2 of ch.1, chapter 3.

⁵⁷ For example Directive 80/767/EEC of 22 July 1980.

public procurement by uniform rules of law.⁵⁸ The almost complete disregard of these rules of law by the participants in the market, these are public purchaser and private sector suppliers,⁵⁹ was encouraged by the absence of any substantial enforcement.

Furthermore, in the absence of rules on aggregation, public purchasers circumvented the rules by splitting up contracts so that no single contract exceeded the respective threshold and had to be advertised.⁶⁰

Finally, the Community rules did not deal with important sectors such as public services contracts and, most notably, contracts in the “excluded” utilities sector, where the potential for significant savings existed.

The European Commission recognised the foregoing malfunction of the early procurement rules in its 1985 White Paper “Completing the Internal Market”⁶¹ as part of its review of the Community’s single market policies. In this, the Commission emphasised again the important role of public procurement within the Community’s general policy of creating a Single European Market and launched the plan of reinvigorating the slow and unsatisfactory integration process in this area.

As a result of the 1985 White Paper, the Commission adopted not only measures to improve the existing Directives and the enforcement mechanisms but also extended the existing regime to the four important “utilities” sectors of water, energy, transport and telecommunications.

To make up for the above-outlined deficiencies identified in the early rules, a set of new Directives were adopted in the late 1980’s, namely Directive 89/440⁶² amending Directive 71/305 for works contracts and Directive 88/295,⁶³ which

⁵⁸ European Commission, op.cit., note 54, p.4.

⁵⁹ European Commission, *Public Procurement in the European Union – exploring the way forward* (November 1996), para 2.6.

⁶⁰ European Commission, “Completing the Internal Market” COM(85) 310 final, para 4.3.

⁶¹ *Ibid.*

⁶² [1989] O.J. L 210/1, of 21.7.1989.

⁶³ [1988] O.J. L 127/1, of 20.5.1988.

amended Directive 77/62 as amended by Directive 80/767⁶⁴ for supplies contracts. The main innovations of the Directives at this stage were the inclusion of the definition of the Directive's scope and more transparent procedures. Both Public Sector Directives only amended the original Works and Supplies Directive but did not implement a consolidated text.

A further major step towards an effective regulatory regime was the adoption of the Remedies Directive 89/665⁶⁵ dealing with remedies for enforcing the public sector rules. Finally, the Council enacted in addition, as part of the rejuvenation of the procurement rules following to the White Paper, the first "utilities" Directive 90/531⁶⁶ regulating works and supplies contracts in this area.

The outcome of this second round of legislative activity had been that legal framework on public procurement was scattered over several instruments and as such not easily accessible for the participants in the market. The above-outline legislation was finally replaced by the three public sector Directives 93/36⁶⁷ (supplies), 93/37⁶⁸ (works) and 92/50⁶⁹ (services), which aligned in a single text the stricter and more detailed rules of their respective area. Moreover, Council Directive 93/13⁷⁰ added a remedies Directive to enforce the utilities sector, so that the following picture of the current procurement regime emerged.

There are two sets of Directives, one set for the public sector and another one for the utilities sector. The public sector rules consist of three Directives for the award of public works, supplies and services contracts and one remedies Directive. The utilities rules consist of two Directives, namely one for the award of contracts in the relevant areas and one distinct remedies Directive.

⁶⁴ [1980] O.J. L215/1, of 22 July 1980, implementing the Community's obligation under the 1979 GATT Agreement on public procurement.

⁶⁵ [1989] O.J. L395/33, of 1989.

⁶⁶ [1990] O.J. 297/1, of 29.10.1990.

⁶⁷ [1993] O.J. L199/1, of 9.8.1993.

⁶⁸ [1993] O.J. L199/84, of 1993.

⁶⁹ [1992] O.J. L209/1, of 1992.

⁷⁰ [1992] O.J. L76/14, of 1992.

The most recent change to this framework of European procurement law has been the amendments to comply with the WTO Agreement on government procurement (GPA 1996)⁷¹ by means of Council Directive 97/52⁷² for the Public Sector and Council Directive 98/4⁷³ for the Utilities Sector. These brought about slight changes in the areas of thresholds, time limits and the provision of information to rejected tenderers and to the Commission.

3.3.2.1. Public sector directives

The first set of Regulations, comprising Works, Supply and Services Directives apply to “contracting authorities.”⁷⁴ This category of entities encompasses “the state,”⁷⁵ meaning central, regional or local governments, and “bodies governed by public law.” The public sector rules define in some detail the latter concept, which encompasses bodies with legal personality whose main funding is from other regulated bodies, or whose directing personnel are mainly appointed by such bodies, or which are subject to control by such bodies. Moreover, “bodies governed by public law” have to be established for the specific purpose of meeting needs in the general interest, not having an industrial or commercial character.

Besides the entities referred to as “contracting authorities,” the Works and Services Directives also regulate certain subsidised contracts⁷⁶ when the element of subsidy exceeds 50% of the contract value, even though the purchaser may be a private entity.⁷⁷ Finally, limited rules in the Works Directive also apply to private sector bodies holding public works concessions.

⁷¹ Based on Council Decision 94/800/EC, [1994] O.J. L336/1, of 22 December 1994.

⁷² [1997] O.J. L328/1, of 13 October 1997; see: Williams, “The Long Awaited Directive (97/52) Amending the EC Public Sector Procurement Regime” (1998) *P.P.L.R.* p.25.

⁷³ [1998] O.J. L101/1, of 16 February 1998; see: Williams, “Directive 98/4 Amending the E.C. Utilities Procurement Regime” (1998) *P.P.L.R.* p.95.

⁷⁴ Cf. Art. 1(b) Supplies, Works, Services Directive, for the U.K. cf. Works Reg. 3 (1).

⁷⁵ Cf. Case 31/87, *Gebroeders Beentjes v. The Kingdom of the Netherlands*, [1988] E.C.R. 4635.

⁷⁶ Contracts covered by Class 50, Group 502 of the NACE classification and contracts relating to building work for hospitals, facilities intended for sports, recreation and leisure, school and university buildings, and buildings used for administrative purposes; and services contracts relating to these activities.

⁷⁷ However, in those instances the Remedies Directive does not apply.

The Public Sector Directives apply to contracts in writing for consideration, which are either public works contracts, public supply contracts or public services contracts exceeding 5 million ECU.⁷⁸ Works contracts are contracts for carrying out works or a work, i.e. activities listed in the Schedule to the Works Directive. A supply contract is one for the acquisition of products, even if the purchase is conditional or a hire purchase, where the contract value lies above 200.000 ECU. Services contracts are concerned with non-construction services worth more than 200.000 ECU, which are further sub-divided in priority and non-priority services. Only the former category is subject to the full rules under the Directive, whilst the latter are subject only to the technical specifications, award notices, and certain obligations on provision of statistics.⁷⁹

The differentiation between the three public sector Directives is *expressis verbis* regulated only for the boundary between supply and services contracts. The contract shall be deemed as one or services, if the value of the service element in question exceeds that of the products.⁸⁰ The legislator refrained from regulating the division lines between works/service and works/supply contracts, which renders it necessary to deal with those boundaries in greater detail below.

If a contract falls within the ambit of one of the three Directives, the contracting authority has to award it in accordance with one of two standard procedures. These are either the open procedure, where any party is permitted to submit a bid for the contract, or the restricted procedure, within which only invited parties may submit a bid. In exceptional circumstances an authority may use the negotiated procedure which does not require formal tendering. There are two versions of this type of procedure adopted in the Directives, namely the negotiated procedure with advertisement (“competitive negotiated procedure”) and the one without

⁷⁸ Dischendorfer, “Current Thresholds under the EC Procurement Directives,” (1999) *P.P.L.R.* CS 21.

⁷⁹ The categories of services are defined according to the CPC in Annex 1 A (“Part A” or priority services”) and Annex 1 B (“Part B” or “non-priority services”) to Directive 92/50.

⁸⁰ Article 2 Services Directive, U.K. Supply Reg. 2(1).

advertisements. The grounds for deviating from the two standard procedures are narrowly construed,⁸¹ and the burden is placed on the purchaser to show that these grounds are met.⁸² It is noteworthy, furthermore, that each public sector Directive contains different grounds of justification for the use of the negotiated procedure.⁸³

Once interest has been solicited for the contract the next step is to assess which of the responding bidders meet the minimum requirements for the project. In open, restricted and negotiated procedure, contracting authorities may examine the suitability of suppliers only on the basis of the qualitative criteria established in the Directives.⁸⁴ The common rules on participation contained in the Directives can be subdivided into three categories, namely technical, financial and legal or “miscellaneous” requirements. Contracting authorities must follow objectively determined and homogeneously specified selection requirements for enterprises participating in the award of public contracts and are generally not supposed to use criteria different from those mentioned in the Directives to exclude bidders from the award procedure.⁸⁵

Whilst in the open procedure every tenderer complying with the basic qualification criteria is automatically entitled to participate in the award procedure, in restricted and negotiated procedure the authority may limit the number of candidates it invites to tender or negotiate by means of a “shortlisting”⁸⁶ exercise.

⁸¹ Case C-199/85 *Commission v. Italy* [1987] E.C.R. 1039, para 14 of the judgment.

⁸² Case C-328/92 *Commission v. Spain* [1994] E.C.R. I-1569, para 15 of the judgment; Case C-57/94, *Commission v. Italy* [1995] E.C.R. I-1249.

⁸³ Cf. below chapter 8.

⁸⁴ Case 76/81 *Transporoute v. Minister of Public Works* [1982] E.C.R. 417.

⁸⁵ Case C-360/89 *Commission v. Italy* [1992] E.C.R. I-3401.

⁸⁶ There is no precise definition contained in the Directives of the terms “selection,” “qualification” and “shortlisting.” This has caused significant confusion for example in the first edition of the Treasury guidance *Step-by-Step Guide to PFI Procurement Process*. The author adopts the terminology suggested by Arrowsmith, Boyle and Treumer: “qualification” refers hereby to the process of selecting suitable contractors by applying the basic financial, technical and legal requirements stated in the Directives. “Shortlisting” is the selection among qualified firms in order to limiting the number of firms participating in the final stages of the procurement process. Treumer, “The Selection of Qualified Firms to be Invited to Tender under the E.C. Procurement Directives” (1999) *P.P.L.R.*, p. 147; Arrowsmith, *op.cit.*, note 2 of ch.1, p.217; Boyle, “E.C. Public Procurement Rules - A Purchaser reflects on the Need for Simplification” (1994) *P.P.L.R.* p.101.

It is controversial which criteria may be employed by the contracting authorities when shortlisting bidders. Some authors argue, based on case *C-360/89 Commission v. Italy*,⁸⁷ that the criteria for shortlisting under the public sector Directives are limited to the qualification criteria. Accordingly, tenderers could only be shortlisted by using the technical and financial requirements in a relative manner. From the author's point of view, this opinion is based on a misinterpretation of the above cited judgment within which the ECJ primarily focused on the question of whether the qualification criteria expressly mentioned in the Directives could be widened to include criteria based upon so-called secondary (environmental, social, etc.) policies. This view is submitted by the Commission in its recent guidance on public contracts. It says "authorities may... limit the numbers of those invited to tender or negotiate only by taking into consideration the candidates with the best qualifications in accordance with the selection criteria specified in the contract notice."

Other authors submit that shortlisting may include, apart from the relative use of selection criteria, the approximation to the award criteria, that is the assessment of which firms are likely to create the optimum competition in the later award stages. Using shortlisting criteria which are approximated to the award criteria, renders it difficult for contracting authorities to satisfy the requirements established by the European Court of Justice in the *Beentjes* case.⁸⁸ The Court emphasised in this case that the "examination of the suitability of contractors to carry out the contracts... and the awarding of the contract are two different operations..." which are "covered by different rules."

Although both procedures may be conducted simultaneously, contracting authorities should not fail to distinguish the distinct criteria applicable. Hence, when examining tenders, contracting authorities may not allow themselves to be influenced

⁸⁷ Case C-360/89 *Commission v. Italy* [1992] E.C.R. I-3401.

⁸⁸ Case 31/87 *Gebroeders Beentjes v. The Netherlands*, [1988] E.C.R. 4653, paras 15, 16 of the judgment.

by the tenderer's financial capacity or give a tenderer who has failed to satisfy the pre-established selection criteria a second chance because they deem its proposal advantageous.⁸⁹ Using, as advocated in the literature, an approximation to the award criteria in shortlisting bidders, is therefore hardly reconcilable with the findings of the Court of Justice.

Hence, during the shortlisting exercise, the awarding authority can limit the number of candidates only by selecting those candidates with the "relatively" best qualification⁹⁰ with respect to the basic qualification criteria specified in the contract notice.⁹¹ In order to ensure genuine competition, the minimum number of shortlisted candidates may not remain under three candidates when the competitive negotiated procedure is used or five when using the restricted procedure.

Once the contracting authority has selected the most suitable tenderers in terms of qualifications, competence, skills and abilities, the remaining ultimate decision is the actual contract award. This decision must be either based on the "lowest price" criterion or the contract must be awarded to the bidder offering the "most economically most advantageous" tender. The criteria used in the award of the contract must be listed in either the contract notice or in the contract documents;⁹² criteria which have not been publicised in this way may not be used in selecting the tender.

3.3.2.2. Utilities sector directive

The second set of European procurement rules deals with the purchases of relevant "contracting entities" which are active as "utilities" in the relevant areas of water, energy, transport or telecommunications. The Directive includes three groups

⁸⁹ European Commission, *Guide to the Community Rules on Public Works Contracts*, para 6.1.

⁹⁰ It is not entirely clear whether beside the relative use of the ordinary selection criteria even an approximation to the award criteria is permissible, cf. insofar: Treumer, op.cit., note 86, p.151 ff.

⁹¹ Where the criteria have not been stated in advance, the authority may not eliminate any candidates who have met the basic criteria from the procedure.

⁹² Case 31/87 *Gebroeders Beentjes v. The Netherlands*, [1988] E.C.R. 4653, at para 21 of the judgment.

of contracting entities, namely contracting authorities within the meaning of the public sector Directives, public undertakings and entities operating on the basis of “special or exclusive rights.” Public undertakings are entities over which public authorities may exercise directly or indirectly dominant influence, by virtue of ownership, financial participation in the entity, or the rules governing it. Conversely, entities are operating on the basis of special or exclusive rights when the authorisation confers licences or concessions having “the effect of reserving for one or more persons the exploitation of an activity.”⁹³

The reason for adopting Community rules regulating the purchases of the entities in the relevant areas was that utilities were not exercising their massive spending power, itself six per cent of the Community’s GDP, on the basis of Community-wide competition.⁹⁴ Beside the particular closed national markets in these areas, the other main reason for the lack of EC-wide competition has been attributed to the “various ways in which national authorities can influence the behaviour of these entities, including participations in their capital and representations in the entities’ administrative and managerial supervisory bodies.”⁹⁵

There are further significant differences between the public sector and the utilities sector rules,⁹⁶ *inter alia* in the areas of thresholds, where supplies and services contracts must exceed ECU 400.000 (ECU 600.000 for telecommunications). The other major difference is that the three award procedures are equal-footed in the Utilities Directive, meaning that contracting entities are free to choose between open, restricted and negotiated procedure.⁹⁷ Finally, there are numerous further differences between both sets of Directives which justify the concluding remark that the rules for utilities are in general more flexible in granting more discretion to the purchasing

⁹³ Utilities Reg.3.

⁹⁴ Brown, "Extension of the Community Public Procurement Rules to Utilities" (1993) *C.M.L.R.* p.722.

⁹⁵ 12th recital of the Utilities Directive.

⁹⁶ Arrowsmith, *op.cit.*, note 13 of ch.3, p.393.

⁹⁷ Article 20 (1) Utilities Directive, Utilities Reg. 13; cf. Brown, *op.cit* note 94, at p. 73.

entity.

3.3.2.3. Remedies directives

Generally speaking, there are two ways in which the rules on public procurement are enforced, namely either by the Commission or by legal action in national courts.⁹⁸

In the first alternative, the Commission examines the authorities' conduct either on its own initiative or following a complaint submitted by an individual, such as an aggrieved bidder.⁹⁹ These proceedings have the disadvantage that they are launched against the Member State and not the purchasing entity as such. A breach of procurement law would constitute, therefore, pursuant to Article 226 EC-Treaty a breach of the Member State's "obligation under the treaty" with no immediate enforcement action being applied under Article 228 EC-Treaty. In considering additionally that the average length of such a proceeding is around 20 months¹⁰⁰ and that it is not clear whether Article 228 ever requires to set aside concluded contracts,¹⁰¹ it can be assumed that aggrieved bidders rather do not choose this procedure for pursuing their interests.¹⁰²

Hence, the second main way of enforcement before national courts is of particular significance for individuals seeking relief in procurement cases. The national fora are not necessarily courts in a formally legal sense as Member States are free to confer review powers on a body which is not of judicial character.¹⁰³ These bodies have to enforce the rights of the individuals in question in accordance with two fundamental principles, namely effectiveness and non-discrimination.

⁹⁸ For an overview on remedies in procurement law cf. Arrowsmith, op.cit., note 2 of ch.1, ch.18; Arrowsmith, *Remedies For Enforcing the Procurement Rules* (1993); Öhler, *Rechtsschutz bei der Vergabe öffentlicher Aufträge in der Europäischen Union* (1997); Tyrell/ Bedford, *Public Procurement in Europe: Enforcement and Remedies* (1997).

⁹⁹ For a more detailed account on the Article 226 procedure cf. Harding/Swart, *Enforcing European Community Rules* (1996).

¹⁰⁰ In 1997 it was 19.7 months: *Proceedings of the Court of Justice and of the Court of First Instance of the European Communities* (1997), p.9.

¹⁰¹ For a more detailed account: Arrowsmith, op.cit. note 2 of ch.1, p. 930 et.seq.

¹⁰² Fernandez Martin "The European Commission's Centralised Enforcement of Public Procurement Rules: a Critical View" (1993) *P.P.L.R.* p.40.

¹⁰³ Case C-54/96 *Dorsch Consult* [1997] E.C.R. I-4961.

The first principle, effectiveness, requires primarily that remedies must be effective, meaning above all rapid, to avoid or diminish any substantial economic damages to the parties involved.¹⁰⁴ Furthermore, as regards to the principle of non-discrimination, “Member States shall ensure that there is no discrimination between undertakings claiming injury in the context of a procedure for the award of a contract as a result of the distinction made by this Directive between national rules implementing Community law and other national rules.”¹⁰⁵ In essence, there are three specific forms of relief, namely interim measures, set aside and damages.

Article 2(1)(a) of both Remedies Directives provides that the national review body shall be vested with the power to award interim relief to suspend or secure the suspension of the award procedure, or the implementation of any decision. The general aim of interim measures is to rapidly correct the alleged infringement and thus to prevent further damage to the interests concerned.

Article 2(1)(b) of both Remedies Directives provides that the review body shall furthermore have the power to set aside decisions taken unlawfully. The question of whether an already concluded contract may be set aside has been expressly left to national law.¹⁰⁶ The Member States are free to provide in this situation that the power of the review body is limited “to awarding damages to any person harmed by an infringement.” The United Kingdom is one of the Member States, which have taken the option to bar remedies other than damages. This effectively places the principle of legal certainty, meaning, in particular, the long term administrative and economic planning of the parties to the contract,¹⁰⁷ above the principle of fair and transparent procedures.

Finally, both remedies Directives provide rules for the award of damages to

¹⁰⁴ Article 1(1) Public Sector Remedies Directive.

¹⁰⁵ Article 1(2) Public Sector Remedies Directive.

¹⁰⁶ Article 2(6) of both Remedies Directives.

¹⁰⁷ Weatherill, “Enforcing the Public Procurement Rules in the United Kingdom,” in: Arrowsmith, *op.cit.*, note 98 of ch.3, p. 283.

persons injured by infringements¹⁰⁸ but neither specify the principle according to which damages are to be awarded nor the method of their calculation. Damages are principally awarded for facts which are designated as “tortious” under common law or “delictual” under civil law on the basis of the common principle that the plaintiff is to be put in the position in which he would have been had the wrongful act not occurred.¹⁰⁹

In pointing out only two of the numerous problems in relation to calculating the damages one should mention the question of whether the aggrieved bidder would have actually obtained the contract had the wrongful act not occurred. Furthermore, it appears rather difficult to specify the bidder’s profits, which he could not realise due to the occurrence of that act.¹¹⁰

The Commission recognised in its Green Paper¹¹¹ that priority in the area of remedies should be given to ensure that individual cases can be effectively resolved at national level, that is in the domestic courts. In pursuing this aim, the Commission has tried in recent years to diminish the remaining deficiencies or at least inconsistencies at national level. The inconsistencies between the national systems include that the amount of damages granted is sometimes limited to the mere recovery of the tendering cost.¹¹²

In this context, the Commission promotes in its Communication¹¹³ the establishment of independent national supervision authorities in order to monitor compliance of contracting entities with the procurement rules. These authorities should serve as one-stop contact points for a rapid, informal solution of problems

¹⁰⁸ Article 2(1)(c) Public Sector Remedies Directive and Article 2(1)(d) Utilities Remedies Directive.

¹⁰⁹ Arrowsmith, “Enforcing the Public Procurement Rules: Legal Remedies in the Court of Justice and the National Courts,” in: Arrowsmith, op.cit., note 98 of ch.3, p. 70.

¹¹⁰ The latter question is of particular significance in complex contracts as under the PFI scheme, where many unknown factors may affect the cost of performance.

¹¹¹ European Commission, op.cit., note 59.

¹¹² Brown, “European Commission Green Paper on Procurement: Exploring the Way Forward” (1997) *P.P.L.R.* CS36.

¹¹³ European Commission, *Public Procurement in the European Union* Commission Communication COM(98) 143, 11 March 1998, para 2.2.3.

encountered in gaining access to public contracts.¹¹⁴ What is more, supervision authorities should make the national remedies system more accessible for foreign bidders.

3.3.3. Fundamental principles of public procurement

In addition to the free movement rules of the E.C. Treaty and the rules of the procurement Directives, the European Court of Justice has developed two fundamental principles, non-discrimination and transparency, and other less pertinent principles, including mutual recognition and proportionality. The principles may impose further obligations on contracting authorities and therefore deserve closer scrutiny.

3.3.3.1. Equal treatment/ non-discrimination

In 1993, the European Court of Justice held in its *Storebaelt* decision¹¹⁵ that the E.C. Works Directive is based on the principle of equal treatment. This judgment has triggered an academic debate as to where the “fundamental principles” find their foundation. The outcome of this on the first glance academic debate is whether or not it is possible to subject contracts which do not fall within the full realm of the E.C. Directives to a regulatory regime based on the principles. These are *inter alia* contracts falling completely outside the Directives, since their value lies below the respective thresholds, or their coverage is not intended by the legislator, such as services concessions. Other contracts relevant to this debate, such as contracts for works concessions or for Annex I B services, are only subject to certain minimum rules laid down in the Directives (“lightly regulated contracts”). Those contracts have the Treaty as their prime legal source, in so far as they do not come within the realm of the respective Directive.

¹¹⁴ “Pilot Project on Public Procurement” concerning the administrative Co-operation on Problem Solution – a project involving Denmark, Germany, Italy, The Netherlands, Spain and United Kingdom. For more information, purposes and background of the pilot project cf. Haagsma, “The European pilot project on remedies in public procurement” (1999) P.P.L.R. CS25-CS33.

¹¹⁵ Case C-243/89 *Commission v. Denmark* “Storebaelt” [1993] E.C.R. I-3353.

Annotators¹¹⁶ and two Advocate Generals¹¹⁷ have submitted that equal treatment and the other fundamental principles were based only on the procurement Directives and do not apply in this way under the Treaty. AG Tesauro held that the principle of equal treatment lies at the heart of “any set of rules governing procedures for the award of public contracts since it is the very essence of such procedures.”¹¹⁸

However, the ECJ supported in *Telaustria*¹¹⁹ the viewpoint of the Commission¹²⁰ and other commentators¹²¹ that these principles originate from the non-discrimination and free movement provisions to be found in the Treaty.¹²² The Court suggested that the principles could be viewed as the very essence of the Treaty provisions instituting and guaranteeing the proper operation of the Single Market.¹²³

Apart from the uncertainty where the principle finds its foundation, it is furthermore unclear whether positive legal obligations arise from the principle.

The Court of Justice held that the legal obligations arising from the principle of equal treatment include that similar situations are not to be treated differently unless this is justified by objective reasons.¹²⁴ This general principle prohibits not only the

¹¹⁶ Braun, “A matter of principle(s) – The treatment of contracts falling outside the scope of the European public procurement Directives” (2000) *P.P.L.R.* p.39; Arrowsmith (ed.) op.cit., note 24 of ch.2, para 7.051.

¹¹⁷ Case C-243/89 *Commission v. Denmark* “Storebaelt” [1993] E.C.R. I-3353, opinion of AG Tesauro, para 18; Case C-275/98 *Unitron and 3-S* [1999] E.C.R. I-8291, opinion of AG Alber para 35.

¹¹⁸ *Ibid.*

¹¹⁹ Case C-324/98, *Telaustria Verlags GmbH* (unreported) December 7, 2000, para 60 of the judgment.

¹²⁰ European Commission, op.cit., note 59, p.13; this view is maintained in the more recent *Draft Commission interpretative Communication on Concessions under Community Law on Public Contracts*, where the Commission argues the point that the principles are applicable to concession contracts. If this is the case, these principles must be viewed as being founded on the E.C. Treaty and not on the Directives, since concession contracts are – with the notable exemptions of works concessions – not at all subject to the regime of the Directives.

¹²¹ Platzter/Öhlinger, *E.U.-Konforme Ausschreibung* (1997) p.23.

¹²² However in Case T-203/96 *Embassy Limousines & Services v. European Parliament* (unreported) para 49, 85 of the judgment the Court referred to equal treatment as an “essential principle for the application of the [procurement] Directive....”

¹²³ It is noteworthy that the Commission has obviously changed its opinion on this question, since it used to argue that “the principle of equal treatment [is] underlying the Directive,” cf. in Case C-243/89 *Commission v. Denmark* “Storebaelt” [1993] E.C.R. I-3353, at para 74 of the report for the hearing.

¹²⁴ Case 810/79 *Überschär* [1980] E.C.R. 2747, para 16 of the judgment; Case C-243/89 *Storebaelt* [1993] E.C.R. I-3353.

obvious discrimination based on nationality, but also bans forms of discrimination which, by applying other criteria of differentiation, lead *de facto* to the same result.¹²⁵ According to the ECJ, the principle must not be interpreted restrictively.¹²⁶

The European Commission sought in its draft interpretative Communication to define the legal obligation arising from the equal treatment principle in some detail¹²⁷ in modelling its regulatory depth closely on the procurement Directives. It argued, firstly, that tenderers throughout the Community should know the rules of the respective procurement in advance and an equal amount of information should be provided to them at the same time.

All offers to be considered during the selection stages of the award procedure should be, secondly, in conformity with the tender specifications in order to guarantee an objective comparison between them. Non-compliant bids should be rejected and variants may only be considered if this has been expressly stated in the contract notice.¹²⁸ According to the Commission, Member States are precluded from reserving public contracts for domestic companies and from giving preferences to bidders originating from a less developed region¹²⁹ or preferences for domestic products.¹³⁰

The Commission maintains in addition that the nature of the initial project must not be changed during the award procedure. Finally, the contractor should be chosen on an objective basis. The Commission's interpretation of the law is controversial¹³¹ and the ECJ has not endorsed the view.

¹²⁵ This covers even measures of non-discriminatory nature, for example: the requirement that the firm to be awarded the contract should be owned by the [Italian] government, cf. Case C-3/88 *Data Processing*, [1989] E.C.R. 4035, para 8 of the judgment.

¹²⁶ Case C-275/98 *Unitron Scandinavia and 3-S* [1999] E.C.R. I-8291, para 31 of the judgment.

¹²⁷ Cf. European Commission, op.cit., note 10 of ch.1, pp.10-12.

¹²⁸ Case C-243/89 *Commission v. Denmark* [1993] E.C.R. I-3353, para 37 of the judgment.

¹²⁹ Case C-21/88 *Du Pont de Nemours* [1990] E.C.R. 889.

¹³⁰ Case C-263/85 *Commission v. Italy* [1991] E.C.R. I-2457.

¹³¹ Arrowsmith (ed.), op.cit., note 24 of ch.2, para 7.014; Braun, op.cit., note 116, p.39.

3.3.3.2. *Transparency*

The ECJ held that the principle of equal treatment implies “an obligation of transparency in order to enable the contracting authority to satisfy itself that the principle has been complied with.”¹³² Transparency aims to ensure undistorted Community-wide competitions between suppliers and allows them to monitor compliance with the procurement rules. The Court has stated that a non-distorted system of competition can only be guaranteed if the various economic players have equal chances in transparent procurement procedures.¹³³ It appears questionable whether the principle of transparency implies the requirement to publish contracts falling outside the ambit of the detailed advertisement rules of the Directives.

On the one hand, the Commission notes that one key element of transparency is, therefore, that all contracts are publicised as early as possible in a medium equally accessible to all interested parties. This does not necessarily means, according to the Commission, that all public contracts have to be advertised in the Community’s Official Journal,¹³⁴ but awarding authorities have to ensure that they choose an appropriate medium of making their intention public, including a contract notice in the national press. The notice should contain the necessary information, including the nature and scope of the works or services expected. It should also include the objective selection and award criteria to be employed. Once the contract has advertised, the Commission considers any material changes to the project’s specifications as incompatible with the transparency principle. The extent to which these procedural rules are elaborated show that the Commission does not only

¹³² Case C-275/98 *Unitron Scandinavia and 3-S* [1999] E.C.R. I-8291, paragraph 31; Case C-324/98 *Telaustria Verlags GmbH*, 7 December 2000 (unreported), para 61 of the judgment.

¹³³ It can be argued that the principle of transparency is in the context of public procurement rather a “principle of transparent procedures”

¹³⁴ European Commission, *op.cit.*, note 4 of ch.2, p.12.

interpret the transparency principle, but seeks to impose detailed positive obligations on contracting authorities.¹³⁵

On the other hand, the European Court of Justice held that the obligation of transparency demanded a degree of advertising sufficient to enable the services market to be opened up to competition and the impartiality of procurement procedures to be reviewed.¹³⁶ Procurement procedures should be formalised and transparent inter alia by employing objective selection and award criteria when auctioning the contract. Companies must be furnished throughout the process with “precise information concerning the conduct of the entire procedure.”¹³⁷ Finally, bidders should be provided with the opportunity to challenge any decision by means of an effective review procedure.

The interpretation of both the Commission and the ECJ in *Telaustria* have been received with criticism. It has been argued that transparency is merely concerned with ensuring the fundamental fairness and openness of the award procedure¹³⁸ and does not impose any further obligations on authorities. In the view of Advocate General Fennelly, the principle does not require the awarding entity to apply by analogy the most relevant provisions of the procurement Directives.¹³⁹

3.3.3.3. Other principles

Apart from the main principles underlying procurement law, transparency and equal treatment, there are other less pertinent principles including “mutual recognition” and “proportionality.”

According to the Commission, the principle of mutual recognition requires contracting authorities to accept the products and services supplied by undertakings from other Community countries if the products and services are capable of meeting

¹³⁵ Arrowsmith (ed.) op.cit., note 24 of ch.2, para 7.015.

¹³⁶ Case C-324/98, *Telaustria Verlags GmbH*, 7 December 2000 (unreported), para 62 of the judgment.

¹³⁷ Case T-203/96 *Embassy Limousines & Services v. European Parliament*, (unreported), para 85 of the judgment.

¹³⁸ AG Fennelly in Case C-324/98, *Telaustria Verlags GmbH*, 7 December 2000 (unreported), para 43 of the opinion.

¹³⁹ For a detailed discussion see: Braun, op.cit., note 116.

the legitimate requirements of the recipient Member State.¹⁴⁰ The application of this principle to procurement projects implies that technical specifications, diplomas, and qualifications have to be accepted when they are recognised as being equivalent to those required by the Member State in which the service is to be provided.

The second less pertinent principle, the principle of proportionality, requires that any measure taken by the public entity should be both necessary and appropriate in the light of the objectives sought.¹⁴¹ In choosing the measures to be taken, a Member State must adopt those, which cause the least possible disruption to the pursuit of an affected economic activity.¹⁴²

Applied to the area of public contracts the principle requires, according to the Commission,¹⁴³ that the definition of performance and technical specification is necessary and appropriate in relation to the objective to be reached. The Commission concludes that it is not permitted for authorities to lay down excessive and disproportionate technical, professional or financial conditions when selecting candidates. Mutual recognition and proportionality are recognised as general principles of European Law in the wider context of the four freedoms, they have not yet been employed by the Court of Justice in a specific procurement context. Although it is possible to identify certain rules in the Directives suggesting that the concepts of mutual recognition and proportionality influenced the Directives,¹⁴⁴ those principles are clearly underlying the Treaty. Insofar as the Commission maintains that the

¹⁴⁰ Case C-340/89 *Vlassopoulou* [1993] 2 CMLR 221; for services: Case C-76/90 *Dennemeyer* [1991] E.C.R. I-4421, para 15 of the judgment.

¹⁴¹ Case T-260/94 *Air Inter SA*, judgment of the Court of First Instance of 19 June 1997.

¹⁴² Cf. for example: Case 122/78 *Buitoni* [1979] E.C.R. 677, para 16 of the judgment; Case 66/82 *Fromançais* [1983] E.C.R. 395, para 8 of the judgment; Case 15/83 *Denkavit Nederland* [1984] E.C.R. I-2171, para 25 of the judgment.

¹⁴³ European Commission, op.cit., note 10 of ch.1, pp.12-13.

¹⁴⁴ Such as the mutual recognition of the respective professional or trade register in Article 21 Supply Directive, Article 25 Works Directive, Article 30 Services Directive.

principles of mutual recognition and proportionality directly stem from the Treaty, the approach outlined in its draft interpretative Communication is not contested.¹⁴⁵

3.4. Need for further research

From the brief outline of PPPs and regulated procurement in Europe one may conclude a discrepancy between the two concepts. PPP schemes on the one hand attempt to introduce entrepreneurial elements into public purchasing. Public sector bodies are supposed to outline business cases, assess complex financial models and, above all, negotiate and enforce long term project agreements.

During the procurement process, the parties want conduct intensive discussions on issues such as scoping, financing and delivering the project. The other concept, regulated procurement, contains rigid procedural rules governing *inter alia* the award of PPPs in Europe. It allows discussions between authorities and contractors only under exceptional circumstances. The regulatory regime is likely to create notable difficulties in the context of PPPs if a strict interpretation is applied to its rules and the underlying principles, such as transparency.

The possible discrepancy between the rules and the requirements of the commercial reality and the related question of how practitioners sought to reconcile both shall be examined in the next chapters. Chapter 4 is concerned with the research design and the underlying legal theory of the study. The chapter outlines how the study attempts to learn more about the discrepancy between the living law and law in the books, its explanations and the forces and institutions sustaining it.

Chapter 5 to 11 shall then highlight seven specific procedural problems in PFI procurement. Each of the seven section shall consist of an analytical part, which highlights the legal issues at stake, and an empirical part, which summarises the empirical findings of the study. Those findings contain the experiences of legal

¹⁴⁵ However, it appears noteworthy in this context that the Commission recognises in its Green Paper (at para 3.26) the principles of equal treatment, non-discrimination, transparency and mutual recognition as “fundamental Treaty principles,” whilst it singles out in its later March 1998 Communication (at para 2.1.2.4.) only equal treatment and non-discrimination.

practitioners in dealing with the specific procurement law issues.

Finally, chapter 12 will analyse the PFI procurement practice as it emerged over the last years in the U.K.

Chapter 4 Methodology

This chapter deals with the methodology to be applied in this research project.

Section 4.1. maps out the research theory by introducing the perspective taken when observing PFI procurement practice. Section 4.2., the second and most substantial part of chapter 4, deals with the design of the study and charts out the research process.

The expositions on the research questions in section 4.2.1. and research subjects in section 4.2.2. are followed in section 4.2.3. by a brief discussion of the collection and analysis of verbal and document-based data. Finally, section 4.2.4. is dedicated to the question of how to establish the trustworthiness of the findings and the dependability and validity of the data.

4.1. Research theory

4.1.1. Introduction

The objective of this study is to analyse the “living” procurement law in the area of the Private Finance Initiative, and to measure the extent of divergence from the norms encapsulated in the “law in books.”

The main theory underlying this research project is that due to an *incompatibility* between the rigid procurement rules and the structural and commercial necessities of PPP projects, lawyers may have developed a legal practice which may be inconsistent with the narrow interpretation of the procurement norms as developed by the ECJ and the European Commission. The incompatibility of the practical necessities with the procurement rules may have resulted in the development of a distinct PFI procurement practice and, ultimately, may have created a gap between the “law in the books” as envisaged by the European legislator and the “law in action” in PFI. In behavioural terms, the procurement law may have failed to make the impact envisaged on the legal practice of contracting authorities delivering PFIs.

Accordingly, the main research question of the project is how practitioners have applied public procurement law in the PFI context. It is feasible to approach this question from three different perspectives.

On the one hand, one could adopt an outsider perspective and examine the impact procurement law has had on the social behaviour of the addressees of legal norms. In the specific context of this research project, a behaviouristically-oriented researcher taking an outsider perspective would ask questions such as whether procurement law has had the impact on the legal practice the legislator intended it to achieve and whether procurement law was “functioning.” The overall aim of such a project might be to examine the “effectiveness” of procurement law in the specific PFI context.

Alternatively, the project could focus on an insider perspective by asking how participants perceive the law and its role in the legal practice. The insider perspective does not examine the question of whether the law is effective or not, but rather seeks to analyse the *meaning* underlying the actions. Finally, there is a third approach, seeking to reconcile the two positions and considering the insider *and* the outsider perspective.

Since the choice of perspective has major repercussions on issues such as the specific research questions asked, the factors considered, the methods employed and the overall aim of the research, it becomes necessary to discuss the different analytical models and their theoretical underpinnings.

4.1.2. Outsider perspective

The outsider perspective, which is traditionally associated with legal positivism, is premised upon the notion of a unified science, with natural sciences providing the model for the social sciences. As Durkheim explained, this perspective “treats social facts as things”¹ which can be measured and analysed in almost the same manner as the natural scientist would measure and analyse substances and processes in laboratory

¹ Durkheim, *The Rules of Sociological Method and Selected Texts on Sociology and its Methods* (1982), pp. 60, 161-162.

experiments. Taking this view, the aim of social science, and of socio-legal research, is to explain social behaviour through the formulation of universally valid causal laws of behaviour which allow for reliable predictions. The formulation of causal laws is based upon the observation of empirical regularities.² It is inherent to a behavioural approach to socio-legal research that law is “always viewed from the outside,”³ from the perspective of an observer of behavioural regularities, rather than that of a participant.

To achieve the self-imposed “objective scientific standard” in socio-legal research, the outsider perspective considers only existing patterns of behaviour external to the observed social actors and abstains from considering “subjective” views and the meaning of the participants.⁴ The insider perspective is regarded as inferior to the objective data, since only the latter allows for formulating objective and universally valid natural laws. Subjective perceptions and meanings of the participants, on the other hand, may change.

The declared goal of this analytical model is to achieve “pure” sociology by emulating the “pure” natural science model of observation and measurement, deliberately ignoring human assumptions, assertions or implications, their preferences goals and intentions, insulated from subjectivity and meaning.⁵

As the outsider perspective is rather interested to quantify and classify social phenomena, this analytical model has the tendency of being associated with quantitative rather than qualitative research methods.

4.1.3. Insider perspective

The insider perspective, which is traditionally associated with interpretivism, challenges the outsider perspective by asserting that social sciences are distinct from the natural sciences. Social sciences are concerned with thinking, interpreting, active

² Black, “The Boundaries of Legal Sociology” (1972) *Yale Law Journal*, p.1076.

³ Cotterrell, *Law’s Community* (1995), p.25.

⁴ Black, “The Epistemology of Pure Sociology” (1995) *Law and Social Inquiry*, p.849.

⁵ Black, *op.cit.*, note 2, p.1092.

subjects who construct the social world through shared meaning, in contrast to the insensate objects studied by natural science.⁶

Building on this recognition, the analytical model stresses the importance of interpreting “understanding” of social phenomena in terms of the motivations of social actors rather than the mere observation of behavioural patterns or measurement of attitudes.⁷ Hence, it is one major aim of the insider approach to detect the factors influencing the decision-making of social actors, such as rules, doctrines, interpretations, reasoning, and arguments.⁸

This is achieved by adopting an “internal, participants’ point of view”⁹ taking into account the understanding of the participants and the complex of rules and meaning that constitutes the social action observed. Whilst some researchers favouring the outsider position acknowledge that it is essential to describe the internal view,¹⁰ the insider perspective goes one step further and interprets the behaviour based meaning.¹¹ They claim that social life is substantially constituted by meaningful social action, which is based on ideas and beliefs of the participants.¹² Those ideas and beliefs are considered as valuable objects of investigation.¹³

Even detailed quantitative data based on questionnaires cannot bring out the full nuance of insider experience and social meaning.¹⁴ Therefore, analysts employing the insider perspective are more likely to have recourse to qualitative research methods.

⁶ Cotterrell, *The Sociology of Law* (1992); Trubek, “Where the action is: Critical Legal Studies and Empiricism” (1984) *Stanford Law Review*, p.575; Gordon “New Developments in Legal Theory,” in: D. Kairys, *The Politics of Law: A Progressive Critique* (1990), p.413.

⁷ Cotterrell, op.cit., note 6, p.11.

⁸ Weber, in: Roth/Wittich (ed.) *Economy and Society*, (1978), p.8.

⁹ Dworkin, *Law’s Empire* (1986), p.14.

¹⁰ Hart, *The Concept of Law* (1994), p.242.

¹¹ Cotterrell, “Why must Legal Ideas Be Interpreted Sociologically?” (1998) *Journal of Law and Society*, p.173.

¹² *Ibid.*, p.171.

¹³ This view is endorsed by “Critical Legal Studies” scholars: Trubek, op.cit., note 6, p.575; Gordon, op.cit., note 6, p.413.

¹⁴ Murphy/Dingwall, *Qualitative Research Methods in Health Technology Assessment*, (1998) *Health Technology Assessment* (2), at p.iii.

4.1.4. Integrated perspective

The third perspective advocates the integration of external and internal perspectives. The integrated perspective combines the interpretation of meaningful social actions with the objective observance of behavioural patterns. It is argued that since behaviour and meaning are inseparable aspects of human interaction, social science must pay attention to both perspectives.

The integrated approach acknowledges that both insider and outsider perspective have their uses, and that most of the paradigms contained within these two approaches contribute interesting and informative perspectives on the social world.¹⁵ Hence, it is sought to reconcile the two polar positions, which have been constructed in fierce opposition to each other, and to augment the strengths of one view by the strengths of the other.

Whilst the integrated perspective concurs with the insider perspective in its criticism of the outsider perspective for ignoring the internal view of the participant and reducing human behaviour to its simplest expression, visible behaviour,¹⁶ it recognises the importance of observing behavioural patterns reflected in the activity. Tamanaha, for example, observes that meaning can only be discerned by investigating behaviour.¹⁷ Nevertheless, ignoring the understanding of the participants helps to focus on their actions, allowing to test whether social actors are in fact doing what they believe they are doing or claim to be doing. Hence, Tamanaha argues that the combination of both views provides a richer picture. The predictive power of behavioural research underpins, and enriches, the explanatory power of the insider perspective.¹⁸

For this research project it is submitted that the social phenomena observed should be examined from every perspective possible. The classic social theorists Max

¹⁵ Tamanaha, *Realistic Socio-Legal Theory* (1997), p.58.

¹⁶ Cotterrell, *op.cit.*, note 6, p.13.

¹⁷ Tamanaha, *op.cit.*, note 15, p.70.

¹⁸ Tamanaha, *op.cit.*, note 15, p.68.

Weber, Karl Marx, and Émile Durkheim, understood the analysis of social phenomena in a broad sense. Max Weber endorsed the viewpoint that social phenomena should be looked at from different angles. “On the one hand he recognised explanation in terms of causality and statistical correlations... On the other hand there was explanation by means of the attempt to understand (“verstehen”) the motivations of the actors.”¹⁹ This approach attempts to overcome the artificial limitations of partial perspectives and allows taking a holistic picture of the observed social phenomenon.

The social phenomenon observed in this study is the “living law” in PFI procurement, this is “PFI procurement practice.”²⁰ But what is a legal practice? Acknowledging several variations of the notion of a practice, this study is build upon the definition suggested by MacIntyre. He defines practice as “any coherent and complex form of socially established cooperative human activity which has its own standard of excellence.”²¹ Accordingly, a legal practice is “what lawyers and practitioners do, their activities, and the norms and standards they follow in pursuit thereof.”²²

MacIntyre’s definition shows that practices are of a variable nature as they may be small or large, trivial or momentous. Additionally, it is difficult to identify precisely what a practice is beyond the broad statement of coherent social behaviour based on own standards. MacIntyre seeks to clarify the notion by saying that practices firstly must not be confused with institutions. For example, while practising law can be described in terms of a practice, the legal system is a collection of institutions.²³

He stresses, secondly, that persons are initiated to a practice by accepting its normative authority and subjecting own attitudes and preferences to the standards

¹⁹ Weber, *Economy and Society*, Roth/Wittich (eds.) *Max Weber - Economy and Society* (1978), p.4 et.seq.; Wilson, *Social Theory* (1983), p.119.

²⁰ Se below section 4.2.2.1.

²¹ MacIntyre, *After Virtue: A Study in Moral Theory* (1984), pp.187-188.

²² Tamanaha, op.cit., note 15, pp.167 et.seq., 184.

²³ Tamanaha, op.cit., note 15, p.169.

which currently define the practice.²⁴ The participants' acceptance of certain standards and behavioural patterns does not entail that practices are internally of homogenous and uniform nature or that participants fully endorse all aspects of the practice.²⁵ Whilst participants will share the basic standards of the practice their attitudes as regards risk-taking may still vary. MacIntyre ascertains that those standards are not immune to criticism, as the practice could not evolve otherwise. On the other hand, persons cannot be initiated into a practice without accepting the authority of the best standards realised so far.²⁶

The question arises whether the living law in PFI procurement can be brought within the realm of MacIntyre's definition of a legal practice. Without going into details at this stage, it is important to note that applying procurement law in PFI projects is a human activity for the purposes of MacIntyre's definition. The activity has its own normative criteria, such as value for money. Chapters 5 to 11 and chapter 12 will discuss whether observable actions (outsider perspective) and accepted standards (insider perspective) in PFI procurement are sufficiently coherent to refer to them as practice for the purposes of MacIntyre's definition.²⁷

The main reason why the study hinges on the notion of "legal practice" is that the concept encompasses the meaning social actors attach to their behaviour *and* their observable actions.²⁸ Hence, understanding social activities in terms of practices helps to study them internally and externally by adopting an integrated perspective.²⁹ Practices are more than the observable behaviour and include the practitioners' views and doctrines. It can be concluded with Cotterrell that the concept of living law, or legal practice, does not make any sense except by having regard to the subjective

²⁴ Raz, *Practical Reasons and Norms* (1975), 5.2-5.4,

²⁵ Raz points out that addressees of a norm may have a practical interest in what is required which leads them "to make normative statements from a point of view which they do not necessarily accept as valid," *Ibid.* p.177.

²⁶ MacIntyre, *op.cit.*, note 21, p.190.

²⁷ See section 12.2.

²⁸ Cotterrell, *op.cit.*, note 6, p.35.

²⁹ Tamanaha, *op.cit.*, note 15, p.194.

meaning which the living law has for participants of the legal area regulated by it.³⁰ In integrating “meaning” and “doing,” practices make therefore ideal objects for studies adopting an integrated perspective.

The following sections introduce the distinct features of each perspective to the legal practice.

4.1.4.1. Outsider perspective

Applying first an outsider perspective to the legal practice under consideration, the research project examines the impact of procurement law on PFI procurement practice.

It is noteworthy that the concept of law underlying the outsider perspective is a functional one. Law is viewed as fulfilling certain functions within the society. Functionalism is theoretically grounded in the analogy between natural and social sciences. The principal consideration underlying this functional approach is how each part of the societal organism contributes to the survival and maintenance of the whole.³¹

This approach is profoundly based on the hypothesis that the law is essentially capable of influencing the behaviour of individuals. This hypothesis is one of the most contested theories among scholars of law and society.³² Furthermore, functionalism has been criticised for alleged theoretical shortcomings, such as the oversimplification of societal processes.

The many studies conducted exploring the impact of a certain legislative measure on parts of the society, are all to a varying extent based on a functional notion when examining whether the legislative measure has made an impact on its social context, meaning whether it has fulfilled its function. This is especially obvious if the

³⁰ Cotterrell, *op.cit.*, note 6, p.35.

³¹ Vago, *Law and Society* (1995), p.53

³² For a summary of the discussion see: Vago, *op.cit.*, note 26, p.285 et.seq.

legislative measure is of highly technical nature and was enacted to fulfil a specified function within the society.

A good example for a technical legislative measure with a confined area of application is the European public procurement regime. It has the wider function of creating competitive, non-discriminatory public procurement markets in the European Union.³³ On a more specific level, the rules enables goods and services to enter freely procurement markets of Member States. It is suggested that establishing competitive and transparent procedures for contracts above a certain value threshold ensures value for money for taxpayers and consumers alike.³⁴

Even if one takes a cautious approach as regards to a functional interpretation of law, one has to admit that the legislator clearly employs public procurement law as a tool to achieve a specific impact. Hence, in the light of the explicit legislators' intentions it seems to be justified to adopt a functional approach to procurement law.

Studying the *impact* of procurement law on PFI procurement practice was identified as one of the key aims of this research.³⁵ The impact of a norm refers to all legally relevant behaviour influenced by a norm, including all side effects.³⁶ The concept of impact is therefore not merely concerned with compliance. When we ask, what is the impact of any given rule, we mean what behavioural change follows the issuance of that rule. The socio-legal literature has extensively discussed possible conditions positively influencing the impact of law on the behaviour of its addressees.³⁷

This study does not pursue the ambition to point out every possible factor playing a role in procurement law making an impact, but to target those conditions which are most pertinent. Possibly relevant conditions for procurement law to impact behaviour

³³ For example: 5th and 14th preamble to Directive 93/36 "Supply" Directive (OJ [1993] L 199/p.1).

³⁴ European Commission, *Special Sectoral Report No.1: Public Procurement* (November 1997), para 1.1

³⁵ Cotterrell, op.cit., note 6, p.35, for an overview of the problems involved in conducting impact studies see: Vago, op.cit., note 26, pp.88-94.

³⁶ Friedman, *Law and Society* (1977), p.127; Friedman/Macaulay, *Law and Behavioral Science* (1977), p.193.

³⁷ With further references: Vago, op.cit., note 26, p.326 et seq.

include the absence of competing rules, the proper implementation of European Union Directives into national law, the consistent re-evaluation of the norms, a positive cost-benefit analysis and the diligent enforcement of rules. These conditions will be discussed in chapter 12.

The study distinguishes the “impact” of rules from their “effectiveness.” While it is acknowledged that both concepts may partially overlap, effectiveness only refers to *net impact*. Accordingly, an act is effective if the provoked behaviour meets the expectations of the legislator and the behaviour is not offset by countervailing side effects. Effectiveness suggests that it is desirable to comply with the law, and that the ideal system is one in which all addressees entirely comply with all legal rules and orders.³⁸ This necessarily raises wider questions related to compliance including whether compliance with a legal act is suitable to achieve its underlying aims and purposes and whether the overall compliance costs are lower than the benefits. If certain rules are found ineffective, studies into the effectiveness of the law may ultimately result in suggesting *how* the law should be regulated to be more effective.

In focussing on the wider impact of procurement law on PFI procurement practice, the study will not address the aforementioned questions relating to the effectiveness of procurement law. Without going into details at this stage, the main goal of the study is not to examine whether practitioners complied with the rules or whether compliance was desirable. The study rather attempts to shed light on the strategies employed by lawyers when dealing with discrepancies between the legal framework and commercial requirements of the legal practice. Exploring the effectiveness of procurement law in PFI is therefore unsuitable to answer the study’s research questions which focus on the practical application of the law.³⁹

³⁸ Vago, op.cit., note 26, p.94.

³⁹ See below section 4.2.1.

It is further suggested that a legal act can have a substantial impact on society, even if it is not “effective” or successful.⁴⁰ Rules may provoke tactics of disobedience, ignorance, and avoidance, which cannot be easily caught by describing a rule as effective. As such strategies are not immediately related to the effectiveness or success of the rules from the viewpoint of the legislator, the legal *impact*⁴¹ and not just the *effectiveness* of the rules has to be discussed.

4.1.4.2. Insider perspective

Exploring the participants’ perspective of a legal practice primarily involves recovering the subjective *meaning* that certain practices have for them, their interpretations of tasks and conduct, and the arguments they employ.⁴² It is inherent to the insider approach that the meaning participants attach to a certain social action may vary quite substantially according to differences in experience, knowledge, and practices of the legal actors. This is especially true of the law, where there is no single ideal legal point of view, but conflicting viewpoints contributing to a professional discourse that is fundamentally argumentative.⁴³ However, the insights thus gained are fundamental to the exploration of the “living law,” meaning the “real-life” law interwoven with the rules written in the law books.⁴⁴

This study investigated insider perspectives by interviewing experts working in different areas of PFI and asking them how they perceive the role of the European procurement rules in PFI procurement. A number of themes were explored. Did they perceive any discrepancy between the procurement law and their practical requirements? How did they perceive this gap and, if they did, how did they try to bridge it? Furthermore, the interviews shed light on practitioners’ attempts to come to terms with various legal uncertainties of PFI procurement. An important and especially sensitive issue is the question of how practitioners assessed the risk of being

⁴⁰ Friedman, op.cit., note 36, p.127.

⁴¹ It is of note that the study does not consider the economic impact of procurement law.

⁴² Cotterrell, op.cit., note 6, p.12.

⁴³ *Ibid.*, p.35.

⁴⁴ Gurvitch, *Sociology of Law* (1947), p.121.

challenged when possibly deviating from a strict interpretation of the rules and whether they balanced this risk against the benefits incurred by adopting a more pragmatic goal-orientated interpretation.

4.1.5. Status of the observer

Irrespective of whether one chooses an outsider, an insider or a combined perspective, the status of the observer has to be clarified. In adding another internal/external distinction, it is possible to differentiate participant observers (internal) from non-participant observers (external). The distinction between the two categories reflects the experience of the researcher in the observed field. The participant observer has some practical experience in the field of study, whilst a non-participant observer has not participated in the practice observed.⁴⁵

This project involves non-participant observations external to the legal practice observed. The author has no practical experience in providing contracting authorities with legal advice in PFI projects.

4.2. Research design

Having opted for an integrated approach to develop and prove the theory outlined in section 4.1., the project firstly looks at the observed legal practice from an external view, by exploring behavioural patterns. The outsider perspective will be based on text-based research and legal analysis of material publicly available or made available to the study. The design of the research based on texts and materials is outlined in section 4.2.3.1. While outsider and insider perspective share the research questions, which will be discussed in section 4.2.1., the remainder of the chapter will focus on the question of how to gain the perspective of insiders. The researcher is an outsider to the practice. Therefore, it has to be further addressed in section 4.2.2. which persons and documents could serve as appropriate research subjects and provide the study with the necessary insider information. Section 4.2.3. will then address the related question

⁴⁵ Tamanaha, op.cit., note 15, p.175.

of how access to the internal perspective of practitioners can be secured. At a final stage of the research process, in section 4.2.4., the trustworthiness of the findings has to be established.

4.2.1. The definition of the research questions

The main research question is *how practitioners applied public procurement law in the PFI context*. It reflects the theme underlying this study, the possible existence of a discrepancy between procurement law in the books and the law in action. The divergence may have been caused by an incompatibility between the rules and the structural and commercial necessities of PPP projects.

It is possible to sub-divide the main research question into more specific questions targeted to seven procedural problems and uncertainties caused by the divergence between the law and commercial requirements. These are pre- and post-tender negotiations, the possibility of changing specifications, the classification of contracts, the choice of award procedure, the selection of bidders and contract award criteria, the treatment of consortia and step-in rights.

These seven procedural uncertainties and problems will be assessed from an outsider and an insider perspective throughout the analytical chapters 5 to 11. They were identified by analysing the existing literature⁴⁶ and conversing with lawyers.⁴⁷

One criterion for selecting the specific research questions has been that they reflect problems regularly confronted by procurement lawyers. Additionally, the selected legal uncertainties shall occur in a wide array of PFI projects to ensure that the discussed issues are relevant to as many circumstances as possible. The specific relevance of each problem for PFI procurement will be discussed in the respective analytical chapter.

⁴⁶ For references see note 24 of chapter 2.

⁴⁷ The lawyers consulted prior to commencing the study included BothSA#2, PubSA#3 and PubSA#11.

Moreover, all seven sets of specific research questions aim at drawing conclusions about the strategies the procuring authorities have adopted. The research questions shall further explore the risks and uncertainties that most PFI projects have in common. Due to the seven legal uncertainties and problems, authorities have no alternative but to accept certain risks when deciding on the procedural options. It is one aim of the study to find out more about the risk assessment in PFI regarding the targeted procurement law issues.

4.2.2. Selecting the research subjects

It has to be decided in a next stage to whom the research questions should be addressed to gain the insider perspective. As researchers have to render an informed decision on the selection of the individual subjects to study, they are usually confronted with three questions. Firstly, what is the total population to be observed and what is the nature of the interest in this population? The second question to be posed is, which particular subjects of the wider population shall be observed? This question is pivotal, since social researchers cannot always observe all subjects relevant to their theory. Problems of access to such subjects and restrictions of time, money, and personnel all limit total observation.⁴⁸ The third and final question arising in this context is which strategies and procedures to employ to select (“sample”) the relevant subjects of the wider population and, interrelated with that, whether or not those selected subjects will permit generalisation to the wider universe. As it is not sufficient to *assume* that findings for the sample are replicated in the rest of the population, researchers have to apply a sampling strategy to be as confident as possible that the observed portion (“sample”) is representative of the total set of events or objects. Data and findings should be qualified accordingly.

⁴⁸ Denzin, *Sociological Methods* (1970), p.100.

4.2.2.1. *The population*

The main object of interest of this research project is *PFI procurement practice* as it has developed in the United Kingdom since 1992 and was employed in the approximately 700 projects planned, signed and, at least partly, delivered under the auspices of the Private Finance Initiative.⁴⁹

In recent years, PFI procurement practice has become increasingly standardised under the influence of a variety of guidance notes issued by H.M. Treasury and other governmental departments, such as DETR and MOD.

Besides those governmental guidelines, procurement practice was very much influenced by legal practitioners advising authorities. The complexity and novelty of PFIs require that contracting authorities, which are the actual addressees of procurement law, have recourse to external legal advice. Legal advisors are in the position to acquaint authorities with procedural options available and to assess the risks attached to each option.

Authorities have lacked the in-house expertise necessary to assess the legal issues involved and, hence, have been largely dependent on the advice of the external experts in deciding which procedural avenue to go down. Authorities especially sought external legal advice when exploring new pathfinder projects which paved the way for further projects in the same area.

Legal advisors can be perceived as key managers in the process of applying the law in the books to real life situations. In other words, they manage the interacting process between the living law and the law in the books on behalf of their clients. Therefore, for answering the specific research questions, accounts of lawyers who advised public sector authorities on PFI projects are especially valuable and more knowledgeable, than the information authorities could provide. Lawyers working in law firms for central and local government departments are the obvious choice for the

⁴⁹ H.M. Treasury, op.cit., note 1 of ch.2, para 1.1.

investigation, since only these experts are capable of providing the study with the in-depth information required. Interviewing legal advisors instead of public sector authorities necessitates that the lawyers know whether their clients implemented the advice given. This question was addressed in the questionnaire and put to the interviewees.⁵⁰ Though they made it clear that “any client has the discretion not to follow our advice,” advisors to the public sector confirmed that their clients generally followed the legal advice on procurement law,⁵¹ “because that is what they are paying for.”⁵² PubSA#6 added that the lower down the awarding body was in the public sector hierarchy, the less likely it had latitude to take its own view on procurement issues.

4.2.2.2. Sampling strategies

Sampling strategies select the appropriate research subjects to be studied and assess whether those subjects will permit generalisation to other cases of the same phenomenon. In designing a suitable sampling method for this research project, one has to consider that any probabilistic method is not practicable, since it is not feasible to provide every legal practitioner in the PFI area with an equal and known opportunity of being chosen for the sample.⁵³ This is mainly due to the reason that the precise number of legal practitioners with PFI experience is unknown. Furthermore, employing a probabilistic sampling method does not seem to be desirable with the above developed research questions. Those questions are targeting “experiences” with rules and focussing on problems best explored by qualitative analytical methods rather than by looking for statistical patterns.

⁵⁰ See question #1b in Annex II.

⁵¹ For example: BothSA#1, BothSA#2, PubSA#1, PubSA#2, PubSA#3, PubSA#4.

⁵² PubSA#1.

⁵³ For a summary of the discussion whether it is appropriate to use probabilistic methods in qualitative research see: Murphy/Dingwall, op.cit., note 14, para 4.1.1.1.

4.2.2.3. Theoretical sampling

For research projects based upon a theory, theoretical sampling is the most suitable selection method.⁵⁴ Emerson defines this selection strategy as sampling “...in which new observations are selected to pursue analytically relevant distinctions rather than to establish the frequency or distribution of phenomena.”⁵⁵ Instead of being concerned, as in probability sampling, with typicality and inferences about the distribution of a characteristic, the researcher aims for theoretical generalisations⁵⁶ beyond the sample. The generalisations are based on the essential linkage between two or more characteristics in terms of some systematic explanatory schema.⁵⁷ Hence, it is not representativeness that forms the basis for generalisation in qualitative research, but rather that the case is held to either exhibit or test some theoretical principle.⁵⁸ Researchers use their hypotheses to make predictions and then seek cases that will allow them to test the robustness of such predictions under different conditions.⁵⁹

The actual selection of the research subjects, the people, texts or events, to include in the research follows a path of discovery in which the sample emerges as a sequence of decisions based on the outcomes of earlier stages of the research.⁶⁰ In seeking such *analytical and empirical generalisations*, a range of sampling techniques are used,⁶¹ including the study of negative, critical, discrepant and deviant cases to explore and extend existing theory.⁶² This is practically done by seeking to test the

⁵⁴ With further references: Flick, *Qualitative Forschung* (1999), chapter 7.

⁵⁵ Emerson, “Observational fieldwork” (1981) *Annual Review of Sociology*, p.351-78.

⁵⁶ Hammersley/ Atkinson, *Ethnography – Principles in Practice* (1995), p.42 et seq.

⁵⁷ Glaser/Strauss, “Theoretical Sampling,” in: Denzin, op.cit., note 41, p.106.

⁵⁸ Silverman, “Telling convincing stories: a plea for cautious positivism in case studies,” in: Glassner/Moreno (eds.), *The qualitative-quantitative distinction in social sciences* (1989), pp.57-77.

⁵⁹ Firestone “Alternative Arguments for generalising from data as applied to qualitative research” (1993) *Educational Researcher*, pp.16-23.

⁶⁰ Lincoln/Guba *Naturalistic Inquiry* (1985).

⁶¹ Yin, *Case Study Research* (1994), p.44.

⁶² *Ibid.*

theoretical proposition in a number of different settings, in particular, in such where it seems least likely that the theories, which have been developed so far, hold good.⁶³

The sample constructed has to be “theoretically meaningful.” That is, it has to build in certain characteristics which help to develop and test the theory. This means for the selection that the sample is constructed in a way that will help not only to further develop the theory, but also to test its limits significantly and to seek out negative instances or contradictory cases in relation to the analytical ideas.

The actual size of the sample, the number of the subjects sampled and the related question of whether the sample is big enough to be statistically representative of a total population, are not major concerns when using a theoretical sampling strategy. Rather, it is important to select research subjects enabling the researcher to make meaningful comparisons to the research questions and the emerging theory. Hence, the researcher has to sample sufficient cases to test the limits of the theoretical proposition in different settings. This means, that the sample size will not only be relatively small, but also that the researcher following the principles of the grounded theory will not want, or be able, to specify at the outset exactly how large the sample will be.⁶⁴ “Sampling aimed toward the development of the emerging theory”⁶⁵ does not end until theory has been adequately *grounded* and no new data are forthcoming.⁶⁶ This situation is referred to as “saturation of the theory”⁶⁷

Theoretical sampling encourages researchers to conduct multi-faceted investigations, considering a number of different *slices of data*. That is different perspectives of different groups with respect to the social phenomenon observed. Glaser and Strauss, who developed the theoretical sampling strategy, argue that the variety of data gathered is highly beneficial, since it yields more information on the

⁶³ Hammersley/Atkinson, op.cit., note 56, p.43.

⁶⁴ Denscombe, *The Good Research Guide* (1998), p.27.

⁶⁵ Glaser/Strauss, “Theoretical Sampling,” in: Denzin, op.cit., note 41, p.105.

⁶⁶ Denzin, op.cit., note 41, p.102; Strauss, *Qualitative Analysis for Social Scientists* (1987), p.21.

⁶⁷ Glaser/Strauss, *The Discovery of grounded Theory: Strategies for Qualitative Research* (1967), p.6.

different categories, and ultimately makes the study more holistic.⁶⁸ According to them, a theory based on diverse data has taken into consideration more aspects and therefore can cope with more diversity in conditions and exceptions to hypotheses.

To employ a theoretical sampling strategy, the research project has to be based upon a theory. Theories attempt to answer “how?” and “why?” research questions and provide explanations and predictions of social phenomena. The main theory underlying this research project, which was outlined in section 4.1.1., is that due to an *incompatibility* between the rigid procurement rules and the commercial requirements of PPP projects, lawyers have developed a legal practice which may be inconsistent with the law in the books. It is suggested that the incompatibility may have resulted in the development of a distinct PFI procurement practice and, ultimately, in a gap between the “law in the books” and the “law in action.”

In a second stage, it has to be explained how to test the validity of the theory underlying this study. Theoretical sampling aims at the development of an emerging theory by selecting research subjects on the basis of their relevance to the research questions, the theoretical position and analytical framework, and, most importantly, the explanation or account to be developed.

During the first quarter of 1999, a range of possible interview and co-operation partners was contacted to test the viability of the empirical study. These experts were chosen both for their experience in dealing with the legal aspects arising in PFI projects and the already existing contacts⁶⁹ with the supervisor of this research project. Informal approaches were made to investigate whether lawyers were prepared to participate in an empirical study on PFI procurement in any ways. More specifically, lawyers were asked about their willingness to share their knowledge and, if possible, to provide access to internal case studies and related files in the course of the empirical study.

⁶⁸ *Ibid.*

⁶⁹ This practice is described as viable in: Hammersley/Atkinson, op.cit., note 56, p.38.

Whilst the majority of the lawyers approached expressed their interest in the research project, others declined to co-operate. The latter group of practitioners justified their behaviour with overriding commercial sensitivity of the cases and confidentiality obligations vis-à-vis their clients. One lawyer argued that the PFI has now reached a state where a sufficient number of deals have been completed rendering further research in this area unnecessary.⁷⁰ However, as the overall response to the request was positive, it appeared viable to conduct an empirical study dealing with PFI procurement.

Requests for interviews were sent to lawyers in August 2000. The potential interview partners were chosen on the basis of two main selection criteria, namely their experience in PFI procurement and the expected diversity of the information provided.

Firstly, lawyers were approached for reason of their experience in PFI procurement as reflected in the position of their firm in the “Legal 500” directory.⁷¹ The directories of 1999 and 2000 recommended law firms and lawyers with PFI experience and contained references to delivered projects. It was inferred from the reference projects that only lawyers working for one of the law firms listed in the directory were capable of providing the study with significant input. Lawyers employed by one of the listed firms have experience with PFI which goes beyond more than just a few projects and the “wealth of expert practitioners matches deal flow with all-around market knowledge and influence.”⁷²

The second main criterion for selecting interview partners was the diversity of the expected information. Theoretical saturation can only be achieved if different perspectives of the studied socio-legal phenomenon are considered, thereby ensuring a

⁷⁰ He probably misunderstood the nature of the project and assumed it would be confined to analysing the grey areas.

⁷¹ The list is available at www.icclaw.com.

⁷² International Centre for Commercial Law, *Legal 500, Private Finance Initiative 1999*.

sufficient bandwidth of data.⁷³ This study sought to test its underlying theory from all possible perspectives considering as many diverse experiences as possible. Lawyers were selected with the intention of ensuring regional diversity, diversity in the PFI projects they have delivered and diversity of their client base.

Firstly, the study sought to ensure regional diversity. It was deemed important that not only lawyers working for national and international law firms were approached, but also those working for firms based in the regions. Whilst lawyers employed by city firms are more experienced in major projects for central government departments in the defence, transport and prison sector, lawyers in regional firms have accumulated experience with health projects and local government schemes.

The regional diversity of the approached lawyers thus ensured, secondly, that the study took into account experience with smaller local PFI projects, including schools, hospitals and local government accommodation. Local government and regional NHS Trusts delivering those local or regional projects were often advised by lawyers based in the regions. For this reason, the sample of 16 lawyers working for national law firms was complemented by eight legal advisors employed by the top regional law firms in the Midlands (Birmingham, Manchester, Nottingham), the West (Bristol) and the North (Newcastle).

The third selection criterion was that the lawyers to be included into the sample should have a diverse client base between them. It was sought to approach not only lawyers who advised public sector authorities,⁷⁴ but also legal advisors with experience in advising private sector clients, including consortia and project lenders. While many of the research questions are concerned with procedural issues which have to be decided by authorities and their legal advisors, the inclusion of private

⁷³ See above p.89.

⁷⁴ Public sector advisor will be referred to as PubSA. The personal pronoun “she” will be attached to them irrespective of their real life gender.

sector advisors was necessary to gain a more complete picture of the PFI procurement practice.

It is of note that procurement law is not only about public sector obligations, but also creates rights for private sector participants in the tendering process. For instance, private sector advisors could contribute invaluable information to the study on why contractors in the United Kingdom did not use the remedy system. In addition, private sector advisors could answer bidder specific questions, including the question of whether consortia considered advertising their sub-contracts according to the procurement rules.⁷⁵ Hence, private sector advisors and lawyers who advised both sectors added an additional dimension to the study.⁷⁶

On the basis of the selection criteria, 27 lawyers were approached in August 2000. The Legal 500 list identified 24 national and regional law firms as especially experienced. Considering the selection criteria, requests were sent to 20 of those 24 lawyers, equalling a coverage of 83.3% of the especially recommended firms. Other lawyers approached worked for regional firms or firms with a lower national ranking. Despite repeated efforts to establish contacts with all of the lawyers approached, three of them chose not to reply to the request for an interview. In total, interviews with 24 lawyers were conducted throughout late August, September and early October 2000. The 24 law firms employing the interviewees represent almost two-thirds⁷⁷ of the market for legal advice on PFI as identified by Legal 500.

After half of the interviews it became apparent that the research had already arrived at the point of “theoretical saturation.”⁷⁸ The incoming data, meaning the experiences shared by lawyers, confirmed the analysis rather than adding new information. The answers given by practitioners became increasingly repetitive and

⁷⁵ Private sector advisor, which will be referred to as PrivSA, will be described with the personal pronoun “he,” irrespective of their real life gender.

⁷⁶ Advisors with private and public sector clients will be referred to as BothSA and will be described with the personal pronoun “he,” irrespective of their real life gender.

⁷⁷ Precisely 63.16%.

⁷⁸ Strauss, op.cit., note 55, p.21.

predictable with the exception of minor aspects resulting from the particular experience of certain interviewees. It was therefore possible to infer that lawyers generally have made the same or very similar experiences when dealing with legal issues in PFI procurement. To confirm this impression and to gain the full picture by including all available nuances of experience, all practitioners who agreed to be interviewed were interviewed.

For the lack of any more precise terminology, the outlined sampling approach is referred to as *limited empirical* and *theoretical generalisability*, aiming at drawing inferences in comparable social settings of other PFI projects. It is submitted that the theoretical sampling method allows for making limited generalisations beyond the studied cases on the general practices pursued in other PFI projects. If this claim is sound, the implication follows that what is said of the setting studied is true of all or most of the settings in the aggregate; and the account should be of interest to anyone who is interested in the general PFI procurement practice.

4.2.3. The research strategies employed

The research strategies applied to develop and test the theory of the study are interviews of experts and text-based research.

4.2.3.1. Text-based research

The research was firstly based on the analysis of the documents and case studies available. The documents and case studies published in the area under consideration were interpreted by employing the usual interpretative methods for legal texts. The resulting interpretations built a cornerstone of the analysis which will compare the law in the books and the law in action and assessing the impact of procurement law on PFI practice from an outsider perspective.

It emerged in the early stages of the study that it is impossible to gain a sufficiently informed insider perspective to PFI procurement practice only by employing traditional text-based research strategies. This is due to the limitations inherent to these strategies. Though practitioners have written some of the available

case studies and reports, those documents do neither convey personal experiences in applying procurement law nor the meaning practitioners attach to their behaviour. To gain insights into the “living law“ it was therefore indispensable to have recourse to empirical research strategies which allow practitioners to directly contribute their views.

4.2.3.2. Interviewing experts

This study sought to gain access to the insider perspective by interviewing experts in the PFI procurement area. Interviewing has a long-standing tradition as a research tool in social science; it has been referred to as the favourite “digging tool”⁷⁹ and the “main data gathering device”⁸⁰ of sociologists. The first part of this section deals with the basic techniques of this research tool before introducing the “expert interview” as a special type of interview, which is pertinent in this study. In conclusion, the section considers how to interpret the data gathered by means of interviewing experts.

The question arose whether it was appropriate to use interviews in this research. Considering the limitations as regards to time and financial resources, probably a trade-off⁸¹ had to be made between breadth and depth. In practice, the researcher may have to decide whether to collect more information that is superficial from a large number of respondents (“surveys”) or collect more detailed information from a smaller number of people (“face-to-face interviews”).

The information required in this study is not only based on sensitive issues, but also on privileged in-depth information. In-depth information concerning personal experiences is best explored in face-to-face interviews providing interviewees with sufficient scope to elaborate on the issues in their own words.

⁷⁹ Benney/Hughes, “Of Sociology and the Interview: Editorial Preface” (1957) *American Journal of Sociology*, p.137.

⁸⁰ Denzin, *The Research Act* (1989), p.102.

⁸¹ Patton, *How to use Qualitative Methods in Evaluation* (1987), p.46.

On the other hand, to draw conclusions about practices prevalent in a certain area of the law, it is pertinent to ensure a sufficiently broad coverage of the area. Hence, conducting in-depth interviews with a small number of interviewees is probably not capable of ensuring a sufficient breadth.

As almost two-thirds of the law firms operating in the market for advice on PFI project participated in the study by way of one of their employees or partners, it can be ascertained that the study has considerable breadth.

It can be concluded that by conducting in-depth interviews with 24 lawyers it was not necessary to make a trade-off between depth and breadth. Conducting face-to-face interviews is therefore a suitable way for collecting in-depth data in this research ensuring a sufficiently broad coverage of the area studied.

Interviews are commonly classified by their degree of structuring and standardisation. The literature differentiates between structured or standardised interview, semi-structured or non-schedule standardised interview, and unstructured or non-standardised interviews.⁸²

Structured or standardised interviews involve that the wording and order of the questions are the same for every respondent. The fact that all questions are identical for every respondent provides the researcher with the opportunity to detect variations between the answers of the interviewees.⁸³

With semi-structured interviews the interviewer has a clear list of issues to be raised and questions to be answered. The researcher will be prepared to be flexible in terms of the order of the topics and to let the interviewee develop his or her ideas. The flexibility in the interview structure allows investigating into the subjective areas of the respondent's mind in an attempt to learn more about his or her point of view.⁸⁴ Non-standardised or semi-structured interviews recognise the respondent as an

⁸² On interviews see: Bailey, *Methods of Social Research* (1987), ch.6.

⁸³ However, this view is based on the assumption that the respondents share a vocabulary and have the same meaning for the questions, cf. Denzin, op.cit., note 70, p.104.

⁸⁴ Bailey, op.cit., note 72, p.191.

individual who may come forward with a unique interpretation of the topic and are well suited to understanding the interviewee's perspective.

Finally, there are unstructured or non-standardised interviews. Here the researcher puts even greater emphasis on the respondents thoughts and seeks to be as unintrusive as possible.⁸⁵ The technique of unstructured interviews stems from psychotherapy and, hence, it is most appropriate for studies seeking to probe the respondents' deepest and most subjective feelings and experiences.⁸⁶

In this project, interviews are a means to discover the insider perspective of PFI practitioners regarding, amongst other things, the legal difficulties and assessments of risks. This proposition renders it necessary that practitioners can convey their professional experiences with the procurement rules by using their own wording and, more importantly, their own interpretations. Hence, wholly standardised interviews are ruled out.

On the other hand, in contrast to narrative or biographic interviews, the researcher interviewing experts is less interested in the person than in his or her capacity as expert in a specific field.⁸⁷ The expert is not considered as an individual case, but as representing a group of particular experts.⁸⁸ The individual expert is not of major interest, but his or her experiences and interpretations in the PFI area.⁸⁹ This proposition limits the scope of relevant information to be gained substantially and it becomes important to steer the conversation by means of an interview guide to focus the discussion on the role of the interviewee as expert.

Interviewing experts is aimed at analysing and comparing the knowledge of the interviewed experts. The commonalities or differences between the individual expert

⁸⁵ See for example the strategy Becker employed to interview marijuana users, Becker, "Marijuana Use and Social Control" (1955) *Social Problems*, pp.35-44, reprinted in Rose (ed.), *Human Behavior and Social Processes* (1962), p.592.

⁸⁶ Bailey, op.cit., note 72, p.192.

⁸⁷ Flick, op.cit., note 43, p.109 et seq.

⁸⁸ Meuser/Nagel, "Expertinneninterviews – vielfach erprobt, wenig bedacht" in: Garz/Kraimer (eds.), *Qualitative-empirische Sozialforschung* (1991), p. 444.

⁸⁹ Arbeitskreis Qualitative Sozialforschung, *Verführung zum Qualitativen Forschen, eine Methodenauswahl* (1994).

interviews are the touchstones for the validity of the research theory. An unstructured interview style is therefore not suitable for the purposes of the study. Having previously ruled out standardised interviews, semi-structured interviews can be deemed most appropriate for questioning experts.

Individuals are deemed experts if they bear direct responsibility in implementing or controlling the solution of a specific problem or have privileged access to sensitive information about decision-making processes. It is important that they hold a position which is influential enough to influence the decision-making process. Lawyers who have given advice to authorities fall within both categories. They have directly influenced the decision-making process of the authority with regards to legal procurement aspects and have had in this position the opportunity to gain access to privileged information. In addition, requests for interviews were only addressed to partners, ensuring the expert status of the interviewees.⁹⁰

Using semi-structured interview, a questionnaire had to be designed to guarantee that the same issues were addressed in each interview. The questionnaire encapsulated the research questions by means of a combination of open-ended and closed-ended questions.⁹¹

Before discussing the way in which the questions are framed it appears worthwhile to recapitulate the specific context within which this research project has been conducted. We have seen in this section that the insider perspective into PFI procurement practice was gained by means of expert interviews.

The implications are mainly twofold: firstly interviewing experts means that the respondent is generally more experienced in the area under consideration than the interviewer. Secondly, the subject matter of the interviews is a highly sensitive one. Experts are interviewed to convey sensitive insider information on, amongst other

⁹⁰ Apart from one senior partner who chose to delegate the interview to a junior colleague, all interviewees were senior associates or partners in their firms.

⁹¹ See Annex II.

things, engaging in a practice which does not always comply with the law. It was anticipated that experts will feel responsible towards their clients and will particularly seek to uphold the confidential details of deals.

Viewing both aspects together it became apparent when drafting the questionnaire that it may become necessary to motivate experts to give full access to their insider perspective.⁹² This was sought to be achieved by introducing context into questions,⁹³ briefly summarising the practice as it has been discovered analysing government guidance and publicly available case studies. For example, Question 2a⁹⁴ states that

*“The overwhelming number of PFI projects
was delivered by using the negotiated
procedure;”*

before asking

*“which procedure do you normally
choose to award PFI contracts?”*

Framing question 2a in a way to presume that the possibly non-compliant practice is widespread put the burden of denial from the mind of the respondents. The interviewer signalled to the respondent that the practice he or she has engaged in is commonly employed and the interviewer was not surprised that the respondent engaged in the practice.

It has been argued that if the anticipated answer of the respondent happens to be in violation of public ideals or norms, then any question which is biased towards the anticipated answer will make it more likely that the respondent admits his deviant

⁹² Gorden, *Interviewing: Strategy, techniques and tactics* (1975), p.339 et seq.; Richardson/Dohrewend/ Klein, *Interviewing. Its forms and functions* (1965), partly reprinted in: Hopf/Weingarten, *Qualitative Sozialforschung* (1979), pp. 205-231, at pp.224 et seq.

⁹³ See for example questions 2a, 2d, 2g, 2k, 3a, 3b, 4d, see Annex I.

⁹⁴ See Annex I.

experience.⁹⁵ That is particularly true when the interviewer's manner shows that he expects the respondent to have had such an experience and that he does not condemn him for it.

What is more, questions containing some context softens possibly "threatening question."⁹⁶ Stating that other practitioners may not have complied in the "overwhelming number of PFI projects" with a literal interpretation of the law places the respondent's own decisions in a non-threatening perspective. It was expected that this would make it easier for lawyers to freely discuss the sensitive issues involved if the question was based on the presumption that "everybody does it."⁹⁷

On the other hand, motivational elements of questions may provide the interviewer with the opportunity to unduly bias the question towards certain, possibly correct, answers.⁹⁸ The question arises whether any undue influence is likely to occur in the specific context of the conducted expert interviews.

It is submitted that potentially distorting effects of contextual elements are minimised where the respondents have accurate information clearly in mind.⁹⁹ We have seen that respondents were selected on the basis of their knowledge and experience in PFI procurement. As in the case of other expert interviews the distorting effect of contextualised questions is minimal as the experts interviewed have a practical knowledge of the subject matter which is superior to the knowledge of the interviewer. Lawyers in this study were very much aware of their superiority which has made them confident to critically assess the presumptions underlying the questionnaire in the light of their experience.

The theoretical consideration that the expert status of respondents minimises any potentially distorting effects of context elements have been confirmed during the empirical stage of this research project. For example, Question 1d contains a bold

⁹⁵ Gorden , op.cit. note 92, p.360.

⁹⁶ Sudman/ Bradburn, *Asking question* (1986), chapter 3.

⁹⁷ *Ibid.*, p. 75

⁹⁸ *Black/Champion*, *Methods and Issues in Social Research* (1976), pp. 339 et seq.

⁹⁹ Gorden , op.cit. note 92, at pp.224 et seq.

statement of a practitioner who said that “the procurement rules are fundamentally incompatible with the commercial necessities of PFI procurement.” Asked whether they agreed, most of the interviewees rejected this statement as being too general and not reflecting their experience.¹⁰⁰ As intended, lawyers used the statement as a starting point to develop their perception of the relationship between regulated procurement and the commercial requirements of PFIs.

Another example against the suggestion that contextual elements have skewed the responses was provided by lawyers who have chosen to adopt a more cautious approach than the general PFI practice in the seven problem areas.¹⁰¹ In the course of the interviews, those lawyers used a number of occasions to reject the approach taken by the mainstream PFI procurement practice which were intrinsic to the questionnaire. They used the underlying presumptions to explain the reasons that lead them to adopt their slightly more cautious approach to procurement law.

In several other instances, practitioners questioned presumptions underlying the questionnaire. For example, only two of the practitioners said they had used a shortlisting criterion related to the development of PFI industries.¹⁰² Similarly, practitioners¹⁰³ rejected the presumption on which question 2d was based that “many PFI practitioners argue (with the Treasury) that PFI projects will regularly come under the umbrella of the “overall pricing” derogation...” In doing so, some respondents used the context provided by the question to freely develop their more detailed and more differentiated responses.

The examples show that the context elements used in the questionnaire were by no means framed in a way containing suggestions for the experts as to the most appropriate answer. Conversely, the respondents remained genuinely free to reject presumptions on which the questions were based. All practitioners showed that they

¹⁰⁰ Inter alia: PubSA#2; PubSA#3; PubSA#4; PubSA#5; PubSA#9; PrivSA#2; PrivSA#3, see below section 12.4.2.

¹⁰¹ Such as PubSA#4; PubSA#3; PubSA#10; PubSA#9.

¹⁰² PrivSA#5; BothSA#4.

¹⁰³ BothSA#3; PubSA#2; PubSA#4; PubSA#7.

were capable and willing to utter their own views by rejecting some of the provoking presumptions put to them and, instead, to reach highly differentiated answers in response.

Summing up the findings it is possible to say that introducing context into questions is, considering the specific field and methodological strategy of this research, a viable way to gain a maximum of data related to the research questions.¹⁰⁴ It is submitted that the way in which the questions were framed did not distort the responses, mainly because the interviewees were in the position to contradict the presumptions underlying the questions and the interviewer did not take control of the interview situation. The non-distortion of the findings was furthermore secured by asking open-ended questions¹⁰⁵ providing respondents with the opportunity to prioritise the procedural problems and develop their experiences.

For the convenience of the interviewees, the interviews took place in their offices and took between 45 and 90 minutes. All but three interviews were recorded by means of an audio tape-recorder. The first two interviews with PrivSA#1 and PubSA#1 were not recorded on the assumption that they would refuse the recording. With the exception of BothSA#6, who expressly said he preferred not to be recorded, this assumption later proved to be unfounded.

The tape recording of the majority of the interviews was to ensure the accuracy of the field notes taken and to provide a more accurate rendition of an interview than any other method.¹⁰⁶ The audiotapes were then transcribed into interview reports which followed in their structure the seven sets of research questions identified in section 4.2.1. A classical transcription *stricto sensu* not only contains the complete verbal actions, including intonations, emphasis and accents used in speech, but also the non-verbal ones, such as gestures. However, with expert interviews it is unnecessary to

¹⁰⁴ Merton/Kendall, "The focussed interview" 1945 (51) *American Journal of Sociology*, pp. 541 – 557, reprinted in: Hopf/ Weingarten, op cit. note 92, pp. 171-204, at p.180.

¹⁰⁵ For example questions 1c, 1d, 5c, see Annex I.

¹⁰⁶ Yin, op.cit., note 61, p.91.

keep details of the non-verbal communication. Documentation of expert interviews is rather concerned with the collection of information and exploration of professional judgment conveyed by that person. For this reason, literal transcriptions are the exception in the context of expert interviews and it is appropriate to paraphrase the conversation.¹⁰⁷ The paraphrase should give a concise account of the insider's information, experiences, and interpretations.¹⁰⁸ The question of which parts of the interview are literally transcribed and which are paraphrased was decided in the light of the importance of the interviewee's statement for answering the research questions and testing and developing the underlying theory.

The verbal data gathered in the interviews were then interpreted with the purpose of detecting commonalities and differences in the experiences of experts.¹⁰⁹ The analysis aimed to explore the existence of a shared knowledge, common structures and interpretational models that can be found in the aggregate.¹¹⁰

The use of an interview guidance ensured that each interview had the same focus based on the same theoretical hypothesis. The interviews were conducted in accordance with the interview guide, and it was therefore likely that they resulted in similar passages, each of which focussed on specific topics. Those passages of the interviews were screened for common themes and structures, but also for discrepancies and positions diverging from each other. In a third step, common behavioural strategies of the practitioners were identified. Eventually, the empirical findings were confronted with the theories on which the project is based. This research strategy allows assessing whether theory and the empirical findings coincide or not.¹¹¹

¹⁰⁷ Meuser/Nagel, op.cit., note 78, p.455.

¹⁰⁸ *Ibid.*, p.157.

¹⁰⁹ Hoffmeyer-Zlotnik (ed.), *Analyse verbaler Daten* (1991).

¹¹⁰ Meuser/Nagel, op.cit., note 78, p.452.

¹¹¹ *Ibid.*, pp. 453-467.

4.2.4. Establishing the trustworthiness of the findings

The research has to be designed and conducted in a manner warranting the utmost trustworthiness of the findings. There is considerable disagreement among qualitative researchers regarding the evaluative criteria that may be applied to the research data, about which criteria are appropriate and about how research may be assessed in relation to such criteria. The traditional categories of internal validity, external validity, reliability, and objectivity, which were developed in the context of quantitative research, are suggested to be inappropriate when dealing with qualitative data.¹¹² Nevertheless, those traditional categories formed the basis for developing three criteria for evaluating qualitative research, namely dependability, validity, and transferability.

4.2.4.1. Dependability

Dependability is analogous to reliability in quantitative research, meaning that it has to be possible to repeat the operations of a study, such as the data collecting procedures, without achieving different results.¹¹³ The dependability of the research depends upon being able to form a judgment of the research process, which led to the findings presented, and hence evaluate the evidence upon which claims are based.

In order to ensure the dependability of the findings, the research processes followed must be clear, systematic, well documented, and provide safeguards against bias.¹¹⁴ Confidence in the dependability of the findings, meaning the accuracy of the data collected, is increased by using interview guides, recording by mechanical means transcribing or paraphrasing the interviews, and the development of a database.

In this research project, dependability of the findings was sought to be established by means of using an interview guide and tape-recording almost every interview. As mentioned earlier, initial interviews were not tape-recorded on the assumption, which

¹¹² Robson, *Real World Research - A Resource for Social Scientists and Practitioner-Researcher* (1993), pp.402-403.

¹¹³ Yin, op.cit., note 50, p.41, 45.

¹¹⁴ Robson, op.cit., note 87, pp.405.

later proved to be unfounded, that interviewees would not agree to be recorded.¹¹⁵ Interviews were then either paraphrased or transcribed and the findings entered into a research database to facilitate the comparison of the data gathered.

To evaluate the evidence upon which claims are based it is noteworthy that, unless stated otherwise, references given to responses of interviewees represent the experience of the respective practitioner and are not representative of the total number of interview responses on the issue.

4.2.4.2. Validity

The second criterion in assessing qualitative research, validity has two components: credibility and transferability.

The goal of credibility, or “internal validity,” is to demonstrate that the enquiry was carried out in a way which ensures that the causal relationship between two phenomena is accurately identified and described.¹¹⁶ One can ascertain with Yin that internal validity poses a major concern only for causal or explanatory studies, where an investigator tries to establish a causal link between two events.¹¹⁷ In such a causal study, the findings can be held to be internally valid when the researcher can show that no third factor interfered with the assumed causal relationship. In descriptive or exploratory studies like the present, which are not concerned with making causal statements, this logic is not directly applicable.

The notion of internal validity may prove beneficial in the case of descriptive or explanatory studies, however, if it is extended to the overall problem of making inferences from such studies. This broad approach to credibility is endorsed by many social scientists.¹¹⁸ The researcher has to consider questions such as the following. Are the inferences being made correct? Do the conclusions do justice to the complexity of the social phenomenon observed? Have the instances been selected on explicit and

¹¹⁵ The only exception was BothSA#6 who preferred not to be recorded.

¹¹⁶ Flick, op.cit., note 43, p.243 et.seq.

¹¹⁷ Yin, op.cit., note 50, p.43.

¹¹⁸ Denscombe, op.cit., note 53, p.213-214; Yin, op.cit., note 50, p.43; Denzin, op.cit., note 70, p.20; Hammersley/Atkins, op.cit., note 45, p.227 et.seq.

reasonable grounds? Have all rival explanations been considered? Is the evidence convergent? Have the findings been triangulated with alternative sources as a way to bolster confidence in their validity? Can informants be relied upon? Is there any reason to suspect lack of candour?

Several techniques have been advocated in the literature to enhance the credibility of the findings, several of which can be described as triangulation.¹¹⁹ Triangulation refers to the use of evidence from different sources (data triangulation),¹²⁰ different methods (methodological triangulation)¹²¹ or different investigators (investigator triangulation).¹²² The term was designed to evoke an analogy with navigation, where triangulation involves locating a “true position” by referring to two or more known fixed points.¹²³ However, extending the analogy to triangulation in social science research does not necessarily imply that there is one single objective position of reality, which can be determined by the use of multiple methods.¹²⁴

In this research project, the two research strategies of interviewing experts and document analysis were combined. Although this approach does not encapsulate a combination of qualitative and quantitative methods, it nonetheless uses more than one research strategy to explore the practice from different methodological angles.

Adopting a “between-methods” approach helped to ensure that the study gained a holistic picture of PFI procurement practice and that all relevant explanations of the legal practice were represented. As regards the insider perspective, the analysis of

¹¹⁹ Denzin, op.cit., note 70, ch.10.

¹²⁰ *Ibid.*, p.237-239.

¹²¹ *Ibid.*, p.236; Denscombe, op.cit., note 53, p.83-85; Campbell/Fiske “Convergent and discriminant validation by the multitrait-multimethod matrix” (1959) *Psychological Bulletin*, p.101.

¹²² Hammersley/Atkins, op.cit., note 45, p.231; Flick, op.cit., note 77, p.249 et seq.

¹²³ Seale, *Qualitative Research* (1999), p.53.

¹²⁴ There is a controversy between positivists and constructivists on what the purpose is of triangulation. This controversy centres around the broader question of whether there is a single point of “truth” that can be identified by means of triangulation. However, it is not necessary to decide on this scientific argument, since triangulation is not used in this project to establish a point of truth, but merely to enhance the robustness and comprehensiveness of the findings. For an in-depth discussion of the issues surrounding triangulation see: Blaikie, “A critique of the use of triangulation in social research” (1991) *Quality and Quantity*, pp.115-136.

documents, such as case studies and NAO Reports, acted as a way to scrutinise whether the procurement practitioners actually did what they claimed to be doing in the interviews.

Text-based analysis is backed up by interpretations of the legal framework in the light of PFI; to identify the problems posed for legal practitioners by the procurement rules and to answer the research questions concerned with the impact of the rules.

Denzin explains that *data triangulation* involves using different sources of data, so that the researcher seeks out instances of a phenomenon in several different settings, at different points in time and space.¹²⁵ The notion of systematically selecting and incorporating different persons and settings is reminiscent of the “theoretical sampling” approach¹²⁶ developed by Glaser and Strauss. Thus, for instance, interviewing people in different status positions, people with different points of view or people working in different areas is expected to enhance the credibility of the findings.¹²⁷

The strategies to achieve data triangulation were the same as those that have been outlined above in section 4.2.2.3. on theoretical sampling. This *inter alia* implied that the researcher was committed to cover as many areas of the PFI procurement practice as possible and to consider divergent views and experiences. This was sought to be achieved by employing a sampling method which ensures that the study reflects regional diversity and is based on experience gained with PFI projects in different areas, including transport, prisons and schools.¹²⁸ Furthermore, the study’s sample takes into account the perspectives of lawyers acting for the different actors in PFI, including public authorities, private consortia and project lenders.

The other criterion to assess the validity of a study is the transferability of the findings. Transferability or relevance corresponds to external validity and

¹²⁵ Denzin, op.cit., note 70, p.237 et.seq.

¹²⁶ Flick, op.cit., note 43, p.249.

¹²⁷ Denzin, op.cit., note 70, p.237; Hammersley/Atkins, op.cit., note 45, p.231-232.

¹²⁸ See above section 4.2.2.3.

generalisability in conventional quantitative research.¹²⁹ This notion refers to establishing the domain to which a study's findings can be generalised beyond the immediate setting. This requires a full specification of the theoretical framework on which the study is based, so that the reader is enabled to see how that research ties into a body of theory and existing knowledge on the area.¹³⁰

It is suggested that in order to generalise findings of qualitative research beyond the immediate setting studied, data must be tested in a second or third setting, where the theory has specified that the same results should occur. This *replication logic* is the same that underlies the use of experiments and allows scientists to generalise from one experiment to another.¹³¹

In this study, the sampling strategy is key to transferability of the findings. As we have seen in section 4.2.2.3. it is sought to generalise the study's findings to its underlying theory by means of "theoretical generalisation." It was explained that theoretical saturation was eventually achieved by studying the socio-legal phenomena in a variety of different settings and considering all available perspectives. The transferability of the findings to other PFIs was further ensured by considering a large percentage, namely 63.16%, of the national market for legal advice on PFI as identified by Legal 500 directory.

¹²⁹ Robson, op.cit., note 87, pp.404-405.

¹³⁰ Murphy/Dingwall/et.al., op.cit., note 14, p.197; Denscombe, op.cit., note 53, p.214.

¹³¹ Yin, op.cit., note 50, p.44.

Chapter 5 Negotiations with bidders

Chapter 5 is the first of seven chapters dealing with a specific legal uncertainty of PFI procurement from an outsider and an insider perspective.

In the course of procuring a PFI solution, public sector clients may wish to negotiate with their prospective private sector contractors on a variety of issues. As it was briefly outlined in section 3.3.2.1., negotiations with bidders are only permitted when the negotiated procedure is employed. Nevertheless, where authorities use one of the two standard procedures, the complexity of PFI projects might render negotiations necessary. This raises the question of the permissibility of negotiations either in the pre-tender (5.1.) or during the post-tender (5.2.) stage of the contract.

5.1. Negotiations with bidders – the legal problems

PFI solutions are complex procurement tasks due to a variety of reasons. The reasons include the elaborate contractual structure of the projects, their long-term nature, the plethora of risks to be allocated and, at least in the early days of the scheme, the general newness of PFIs. Apparently, these factors give rise to the need for consulting prospective bidders on fundamental aspects of the project when outlining the business case. Among the aspects are the size and length of the PFI contract, the balance between asset provision and service delivery, the scope of risk transfer, the ownership of the asset at the end of the contract and the management of staff.¹

As the outline business case should be a realistic assessment of the project's viability and scope,² the awarding authority is interested in gaining as much information and reassurance as possible from its prospective contracting partners. Issues the authority is interested to learn more about include the general viability of the project ("market testing"), the proposed risk analysis, and the design of the

¹ Treasury Taskforce, op., cit., note 8 of ch.2, p.13.

² Treasury Taskforce, op.cit., note 86 of ch.2, p.5.

specification (“technical dialogue”).³

The following section examines the issues relating to pre-tender negotiations including the three types of pre-tender negotiations and the legal requirements under which these negotiations might be conducted.

It is feasible to distinguish three types of pre-tender negotiations in view of their different subjects of discussion, namely “market testing” exercises, consultation on the Public Sector Comparator and “technical dialogue.”

5.1.1. Testing the market

Primarily in early PFI schemes, so called “pathfinder projects,” awarding authorities undertook market sounding exercises. They approached “key players” in the market and other potential participants⁴ to ask for their interest in the PFI approach.⁵ This practice ensures from the viewpoint of the authority that firms with a potential interest in the procurement know of the proposals before it is advertised in the Official Journal of the European Communities (OJEC). Market testing provides the authority with the confidence that there is sufficient market interest in the PFI and it is worthwhile to stage competition.⁶ Moreover, after a formal market testing procedure the authority is equipped with a more qualified basis to render a conclusive judgment of the overall viability of PFI solutions in the respective market and the scope of the individual project.⁷ What is more, the department acquires thereby assistance in drafting the project’s output specifications.

After informal consultations, the private sector can prepare itself for the new challenges posed on it by the newly developed scheme. Advisers can be consulted on how to prepare for the PFI procurement procedure and possible partners for the creation of consortia can be sounded out. Hence, it is feasible to conclude that both

³ Treasury Taskforce, op.cit., note 8 of ch.2, p.12-13.

⁴ Such as: construction companies, manufacturers, facilities management and service providers, bankers, financiers, insurers, legal advisers and other equity participants.

⁵ NAO/DETR, op.cit., note 40 of ch.2, p.12.

⁶ *Ibid.*, p.5.

⁷ H.M. Treasury, op.cit., note 43 of ch.2 (IT – Practical guide), para 2.

participants to this consultation exercise, the public and the private sector regularly benefit from market testing.

Due to these benefits, the Treasury “strongly advocates that the client should consider sounding out the possible market place before embarking in the formal procurement process.”⁸ This advice does not appear to be solely limited to pathfinder projects meaning projects without precedence. Market sounding also appears useful in regular PFI projects to ensure that the investment solution is sufficiently well defined so as to interest potential suppliers.

Nevertheless, the authority is not able for factual reasons to discuss with all prospective participants on their perception of the viability of the scheme. Even if the authority provides bidders which were not consulted on the issue with the information gained during the market sounding exercise, companies that were consulted are likely to have a competitive edge. Authorities are likely to consult “national champions,” meaning well-established national firms, rather than undertakings from other Member States. The reasons why it is more likely that national firms are consulted include convenience, not existing language problems, possible experience of working together⁹ and lower transaction costs through the mere geographical proximity. It can be concluded that firms which have been disregarded in the course of the market testing exercise are likely to face disadvantages in the procurement process. Those firms are rather foreign than domestic.

It appears arguable that informal consultations on the viability of a project scheme do not provide the prospective participant with a competitive advantage that could not be remedied. Other interested parties could be furnished with the information obtained during the market sounding exercise.

As it cannot be ruled out that market testing does not unilaterally favour firms, which took part in this exercise, it appears necessary to examine the legal implications

⁸ Treasury Taskforce, op.cit., note 86 of ch.2, p. 5.

⁹ Bohann/Redonnet, op.cit., note 4 of ch.2, p.168.

of this practice.

5.1.2. Consultations on public sector comparator

The National Audit Office highly recommends consulting independent contractors on the development of the public sector comparator (PSC).¹⁰ This pre-tender consultation exercise also includes discussions with prospective suppliers.¹¹ A PSC is a benchmark against which value for money of a PFI project is assessed.¹² It has to be noted that the PSC is not only used for initially assessing the viability of the PFI approach regarding the individual project, but furthermore to compare the net present value of the preferred private sector bid.¹³

The comparator is constructed on the basis that the procurement is undertaken through conventional funding and that significant managerial responsibility and exposure to risk is retained by the public sector.¹⁴ It should centre on the forecast whole life costs of a realistic public sector solution for delivering the same outputs as the PFI option throughout the contract period. The PSC should further reflect the authority's past experience of traditional procurement, including cost and time overruns, variation orders and the true long-term cost of maintaining operational standards at the required performance level.¹⁵

If there is no realistic prospect of a publicly funded solution being available within a realistic timescale, it is still regarded as good practice to develop and refine a realistic public sector solution to provide essential management information during the procurement process.

The comparator should include estimates of the value of the risks to be transferred to the private sector. Hence, the authority letting the project agreement is especially interested to find out more about the appetite of the private sector to assume

¹⁰ Treasury Taskforce, op.cit., note 14 of ch.2.

¹¹ NAO, op.cit., note 86 of ch.2.

¹² *Ibid.*, para 1.3.1.

¹³ Private Finance Panel, *Case Study – Ferryfield House Edinburgh*, para 3.7.

¹⁴ DETR, op.cit., note 9 of ch.2, Glossary.

¹⁵ *Ibid.*, para 4.19.

certain types of risks. To understand the risks which the prospective contractors are willing to assume may turn out as the most valuable outcome of the pre-tender consultations, since the risk allocation is one of the most contentious issues in PFI.

The importance of having a full understanding of the proposed risk allocation¹⁶ as early as possible¹⁷ is highlighted by the naive approach initially taken by public sector departments. The most notable example was the initial attempt to transfer volume risk under the DCMF prisons contract to the private sector.¹⁸ Therefore, the presumption should be that some form of comparator is necessary for PFI projects with the possible exception where there has been collected a significant body of evidence from a series of previous projects.¹⁹

Comparators are only required where public money is involved. Hence, a public sector comparator is both unnecessary and unhelpful in financially free-standing projects, which involve no public money. In those types of projects, it is the private sector investor's responsibility to take a view whether the project is suitable for investment.

It should not be lost out of sight that the PSC is *inter alia* the benchmark against which the performance of the contractor is assessed. The involvement of future contractors in setting up the point of reference is therefore problematic. From the viewpoint of the competitors that have not been consulted for this consultation exercise, there is the danger that the consulted undertaking may persuade the authority to adopt a certain risk allocation.

The capability to assume risks varies among bidders depending on their financial and managerial resources. Hence, this practice may favour certain consortia over others. It must be paramount for the authority to ensure that all bidders have equal access to the information and that interests from other parties are taken into account.

¹⁶ Morrison/Owen, op.cit., note 71 of ch.2, p.15.

¹⁷ Private Finance Panel, op.cit., note 72 of ch.2, p.3.

¹⁸ *Ibid.*, p.18.

¹⁹ H.M. Treasury, op.cit., note 14 of ch.2, para 2.3.2.

Nevertheless, as with the market testing exercise, it cannot be ruled out that companies which had been consulted on the PSC are treated more favourably than those which learned to know about the business opportunity only through the OJEC notice. Therefore, it becomes necessary to scrutinise the compatibility of this practice with the E.U. procurement regime in more detail below.

5.1.3. Technical dialogue

A further pre-tender consultation exercise is the “technical dialogue” between the authority and private sector experts regarding the question of how to draw up the project specification.²⁰ This problem is likely to arise due to the complexity of the multi-faceted PFI contract and the corresponding lack of in-house expertise. Involving potential providers in such early stages of the procurement is further undertaken to enhance the understanding of the public sector purchaser of the range of available options. This is particularly true for large scale IT projects, where the authority may not know its needs at the outset of the procurement process.²¹ It is submitted that under those circumstances, authorities do not enter into pre-tender negotiations only for convenience reasons. The early technical dialogue with experts “pays value for money dividends” further down the procurement process, as there is less need to reconsider non-compliant bids.²²

To influence authorities in the process of drafting specifications is probably the most powerful tool for private sector contractors to ensure that they win the contract. Awarding authority may have an idea of the desired outcome in the more general terms, but there is likely to be a range of specific outcomes consistent with the general aim.²³ Hence, if a service provider is employed to advise on exercising the authority’s discretion on possible solutions, it will seek to favour the solution it can provide. This

²⁰ On project specifications: Treasury Taskforce, op.cit., note 154 of ch.2 (Practical Guidance).

²¹ Treasury Taskforce, op.cit., note 43 of ch.2 (IT – Practical guide), para 3.2.

²² CBI, op.cit., note 98 of ch.2, p.22; H.M. Treasury, op.cit., note 86 of ch.2, stage 10.

²³ Chaves/Dees, “The use of the negotiated procedure in the PFI” (1997) *Construction Law*, p.59.

is of particular relevance in IT projects procured under PFI, where government departments are likely to only a broad understanding of their needs. When consulting the department on the project specification, IT suppliers have the opportunity to encourage the adoption of a technical solution which provides them with a competitive advantage over its competitors. The competitive advantage may stem from the fact that suppliers own intellectual property rights in the proposed solutions.

The authority conducts the technical dialogue with experts in the field to receive suggestions on possible technical solutions. Hence, it is inevitable that discussions with firms influence the later choice of a product or service.²⁴ Furthermore, the participation in pre-tender talks allows to gather more detailed information on the needs of the authority than this would be possible on the basis of a “paper specification.” Viewed from this point, the consulted provider has a competitive advantage over other operators in the market, which took no part in the consultation exercise.

It is arguable that competitors of the consulted undertaking have a genuine interest that the authority discusses technical issues before embarking on the formal procurement process. This avoids delays and related higher transaction costs for preparing bids even on their side.

As with the market testing exercise and the consultation on the public sector comparator, the technical dialogue may give preference to firms that have taken part in the pre-tender negotiations. It becomes necessary to consider the legal implications for the procurement process in the next section.

5.1.4. Legal requirements established by the procurement rules

The three types of pre-tender discussions identified appear to give the participating private sector firms ample opportunities to influence the choice of the public authority. In fact, the latter explicitly has recourse to external sources only for

²⁴ Arrowsmith, “Discussions in award procedures under the E.C. Procurement Directives” (1998) *P.P.L.R.* p.68.

the sake of being provided with input on the different issues. The three consultation exercises generally happen to occur at the same stage of the PFI procurement process, namely before the publication of the Contract Notice in the Community's Official Journal.²⁵

The question arises whether the principles derived from the procurement Directives provide rules for limiting the authority's discretion to commence pre-tender negotiations. The legal requirements imposed on the authority are likely to differ according to the chosen award procedure. The negotiated procedure will provide much more room for negotiations than the open and the restricted procedures.

5.1.4.1. Requirements under open and restricted procedure

Under the public sector Directives and the U.K. public sector Regulations, awarding authorities are normally bound to employ either the open or the restricted procedure.²⁶ The rules on both standard procedures are silent on the matter of pre-tender negotiations. This implies that only the principles underlying the procurement Directives can restrict the discussions.²⁷ The aim of this analysis should be to attain an overview about the arguments that can be derived from the procurement principles and the Directives on the question of whether it is possible to conduct pre-tender negotiations under the open or restricted procedure.

The European Court of Justice derived from the procurement Directives in its jurisprudence two basic principles, namely "equal treatment," and "transparency."²⁸ Another principle underlying the European procurement regime at stake is that of genuine competition between bidders in the field of public contracts. The latter is included in the preambles as one of the main goals of the procurement Directives.²⁹

²⁵ Cf. Treasury Taskforce, op.cit., note 86 of ch.2, p.4-5; Neeta, "The Revised Step by Step Guide to the PFI Procurement Process" (1998) *P.P.L.R.*, CS158.

²⁶ The question of whether this general rule is justified or not, will be dealt with at greater detail below, particularly with having reference to complex procurement tasks such as PFI.

²⁷ Arrowsmith, op., cit., note 53, p.69.

²⁸ Case C-243/89, *Commission v Denmark* [1993] E.C.R. I-3353; Case C-87/94, *Commission v Belgium* [1996] E.C.R. I-2043.

²⁹ For example: 14th recital of the preamble of the Supply Directive 93/36.

The principle of competition is further inherent in the principles of equal treatment and transparency.

Market sounding exercises consultations on the PSC and technical dialogue may be a breach of the general principle of equal treatment under the Directives.³⁰ The principle requires that all firms that are later participating in the procedure should be given the equal opportunity when formulating their proposals.³¹ This means as regards to pre-tender negotiations that bidders which did not participate in these discussions have to be given the same amount of information as those, which were consulted prior to the advertisement of the contract. It has been submitted that discussions should be conducted in general meetings rather than on a private basis to ensure that interested suppliers are treated equally.³² It seems feasible to argue against this interpretation that the mere provision of the outcome of the pre-tender talks is not capable of remedying the competitive disadvantage suffered by non-consulted tenders. For practical reasons, it is not possible to consult every possibly interested provider throughout the European Community. Therefore, the provision with an equal amount of information should be considered as an appropriate means to ensure compliance with the principle of equal treatment.

The provision of equal information is further required by the principle of competition. Bidders should be granted a level playing field on which to compete for the public contract. Moreover, the slightest appearance of a competitive advantage of the consulted firms, would render genuine competition impossible, since other competitors would presumably refuse to prepare or sustain a costly bid for a PFI project on this ground.

The principle of transparency requires that non-consulted bidders should be provided with the outcomes of pre-tender discussions. If one places a strong emphasis

³⁰ Arrowsmith, op.cit., note 2 of ch.1, p.616.

³¹ Case 87/94 *Commission v. Belgium* [1996] E.C.R. I-2043, para 54 of the judgment.

³² Treumer, "Technical Dialogue Prior to Submission of Tenders and the Principle of Equal Treatment of Tenderers" (1999) *P.P.L.R.* p.147.

on transparency, it is arguable, that the mere provision of the outcome of the discussion rounds is not sufficient to warrant transparent procedures. It has to be considered that bidders, which were not consulted prior to the contract advertisement, are only put at a relatively slight competitive disadvantage. If one would require the authority to conduct pre-tender negotiations with all interested parties, the authority had to negotiate possibly with a large numbers of companies. Such a practice would require significant time and financial expenses which are disproportionate in relation to its benefits.

Even if authorities take the fundamental principles into account, there remains a great deal of uncertainty whether the procurement Directives require that open and restricted procedures should be conducted entirely as a “paper” procedure. This includes the question of whether discussions should be generally outlawed. The existing procurement Directives do not expressly regulate pre-tender negotiations.

One reason for casting doubts on the permissibility of pre-tender negotiations is a statement of the Council and the Commission concerning Article 7(4) of Council Directive 93/37³³ which asserted that “in open and restricted procedure all negotiations with candidates or tenders on fundamental aspects of contracts... shall be ruled out.” This statement is not legally binding. It may be employed though as a teleological argument to ascertain that it was the intention of the legislator to prevent entities from entering into discussion with bidders. Pre-tender negotiations address fundamental aspects of the contract, such as risk allocation and the contract’s general viability. Consequently, one can assume from the statement that the Commission will generally deny using pre-tender consultations with prospective bidders.

It should not be lost out of sight that regulating public procurement in a supranational context is not a means to an end. It should rather seek to provide a framework for improved industrial efficiency and competitiveness of European firms

³³ June 14, 1993, OJ [1994] L 111, at 114.

in global markets³⁴ and reduced public sector purchasing costs by means of efficient purchasing practices.³⁵ It is submitted that pre-tender negotiations are not only conducted for convenience reasons. Authorities have justifiable economic considerations for conducting pre-tender negotiations which have to be brought in balance with the legal constraints imposed by the Directives. Consulting prospective tenderers on fundamental issues can realise economic benefits for the public and the private sector by significantly reducing the transactions costs.³⁶

Another strong argument in favour of consulting prospective suppliers in advance can be deduced from the recital of Directives 98/04 and 97/52.³⁷ Both Directives were recently³⁸ adopted by the Council to align the European Procurement Directives with the WTO Agreement on Government Procurement (GPA).³⁹ The tenth recital of the preamble to Directive 97/52 and the thirteenth recital to the preamble to Directive 98/04 state that

“contracting authorities may seek or accept advice which may be used in the preparation of specifications for a specific procurement, provided that such advice does not have the effect of precluding competition.”

Unfortunately the European legislator did not specify what kind of advice amounted to “precluding competition,” although this term is defined by Article VI (4) of the GPA.⁴⁰ The GPA itself provides that

³⁴ European Commission, op.cit., note 10 of ch.1, para 1.13.

³⁵ European Commission, op.cit., note 91, p.3.

³⁶ NAO, op.cit., note 86 of ch.2.

³⁷ Council Directive 98/04, [1998] O.J. L101/1 of 16 February 1998; Council Directive 97/52, [1997] O.J. L328/1 of 13 October 1997.

³⁸ It has to be noted that the Directives 97/52 and 98/04 came into effect only on October 13, 1997 and thus was not available as legal source for earlier PFI projects.

³⁹ Initially, the Commission proposed to amend the Directives by including the exact wording of the GPA in its four contract Directives. However, this proposal, which was contained in COM (95) 107 final, was subsequently dropped during the legislative process. The reason for this could be, that it was assumed that the rule expressed in the GPA Article IV is already part of the principles derived from the E.C.-Treaty by the Court of Justice.

⁴⁰ Agreement on Government Procurement reached in the Uruguay Round, signed on April 15, 1994.

“entities shall not seek or accept, in manner which would have the effect of precluding competition, advice which may be used in the preparation of a specific procurement from a firm that may have a commercial interest in the procurement.”

Even though the rule contained in the GPA is more elaborate than the recitals of the both European Directives, it still appears difficult to judge when this important principle will be liable to be breached.⁴¹ Furthermore, the recitals of the Directives do not have the legislative character of a Directive's article. The Commission pronounced that it would consider the “absence of call for tender or the use of discriminatory specifications... as a prima facie infringement.”⁴² It can be assumed that this prima facie evidence is held to be sufficient even if an authority lets a contract which does not fall within the realm of the GPA but within the realm of the European procurement regime.

Discriminatory specifications reduce the number of possible providers and products to the detriment of others and thereby preclude competition. For example, if a provider consulted the contracting authority in pre-tender discussions and the specifications are later drawn up so as to substantially favour its products, it can be assumed that the specifications discriminate against other providers. In addition, cases in which competition is *de facto* precluded will invariably infringe the rules on specifications or the advertising rules contained in the Directives. In cases where the consultation of prospective providers purely limits competition, for instance to a certain type of material to be used for building a road, competition cannot be regarded as precluded. These discussions must, therefore, be viewed as reconcilable with the Directives. Nevertheless, it remains to be seen in both cases how the Commission will

⁴¹ Williams, "The European Commission's Communication on public-private partnerships in Trans-European transport network projects" (1998) *P.P.L.R.* CS 97.

⁴² European Commission, *Communication from the Commission on Public-Private Partnerships in Trans-European Network Projects*, COM (97) 453 final, p.3.

assess the particular facts.

A way to ensure that the competition requirement is not precluded within the meaning of the recitals newly introduced to the Directives, is to observe the advertising rules contained in the Directives. Those rules furnish public sector authorities with explicit provisions to provide national suppliers with information prior to the advertisement either by means of a “Periodic Information Notice” (PIN) or a “Contract Notice.” They further spell out that the contract ought not to be published in the national press prior to its dispatch to the Community’s Official Journal. The notice in a national gazette may not contain more information than the O.J. notice.⁴³

In the context of pre-tender negotiations, it is possible to deduce two aspects from the advertisement rules of the procurement Directives. Firstly, as a matter of time, the advertisement of a procurement should not be published in national gazettes prior to the publication in the OJEC. Secondly, as a matter of quality, the information for national suppliers may not contain more details than the OJEC notice. If it can be implied from the Directives that certain, most notably national, suppliers should not be treated more favourably regarding the timing of the information and its quality. It therefore seems doubtful whether the authority is allowed under both the standard procedures to approach certain providers before the PIN notice has been dispatched.⁴⁴ This would entail that the consulted providers know the procurement opportunity prior to their competitors. They are also likely to attain “insider” information which is not susceptible from the formal advertisement or the contract documents.

It could be argued that the practice to inform providers about the contract seems acceptable, if this is done after the advertisement is placed and no additional information is provided.⁴⁵ This strict interpretation of the rules on advertisements has the advantage to coincide with Article VI(4) GPA. According to this provision,

⁴³ Article 9(9) Supply Directive; 11(11) Works Directive; 17(6) Services Directive; 25(5) Utilities Directive.

⁴⁴ Cf. Arrowsmith, *op.cit.*, note 2 of ch.1, p. 195-196.

⁴⁵ *Ibid.*, p. 206.

competition should not be precluded by accepting advice in the preparation of specifications for a specific procurement from anyone that may have a commercial interest in the procurement.

Even if the contracting authority place a PIN notice in the Official Journal it remains questionable how it should choose whom to consult from amongst those responding to the PIN. As this situation is not expressly regulated in the Directives, the equal treatment principle has to be applied again. The principle requires that comparable situations are treated equally unless this is justified by objective reasons.⁴⁶ Hence, where a contracting authority receives only a small number of responses to its PIN, all interested bidders have to be invited for consultations. In the more likely event that a considerable number of bidders respond, it is justifiable by commercial reasons, such as disproportionate transaction costs involved, that the contracting authority consults with some respondents only.⁴⁷

In the light of the existing uncertainties, authorities which conduct pre-tender consultations under the two standard procedures, should ensure the placement of a PIN notice so as to meet the minimum transparency and equal treatment criteria. Procuring authorities are not allowed to embark on pre-tender negotiations unless they have dispatched a PIN in the Community's Official Journal and thereby formally requested advice from firms interested in the project. In the meantime, this practice has become the official policy suggested in Treasury guidance notes⁴⁸ and appears to be the accepted practice of public purchasers.⁴⁹ Besides advertising the PIN, authorities should provide bidders, which were not consulted, with the information obtained during the consultation exercise.

⁴⁶ Case 810/79 *Überschär* [1980] E.C.R. 2747, para 16 of the judgment; Case C-243/89 *Commission v. Denmark* [1993] E.C.R. I-3353.

⁴⁷ It is not possible to provide a number of respondents justifying the consultation of only certain providers. This is dependent on the size of the project and the costs of conducting such a pre-tender consultation process in the given case.

⁴⁸ Treasury Taskforce, op.cit., note 8 of ch.2, page 5.

⁴⁹ For example OJ notice 099/1999 of Portsmouth City Council, dispatched on May 12, 1999, where the council expressly is looking to ascertain scope, size and nature of the services to be provided under the pilot project.

5.1.4.2. *Requirements under negotiated procedure*

To avoid the uncertainties in the open and restricted procedure referred to above, the authority may employ the negotiated procedure. Recall that the Commission⁵⁰ and the Court of Justice⁵¹ understand the negotiated procedure as exceptional. Therefore, purchasing authorities have to prove that the circumstances of the case satisfy the requirements of a derogation laid down in a public sector Directive.⁵² In cases where the authority is capable of satisfying the requirements, the negotiated procedure permits pre-tender negotiations with tenderers. This goes even if the authority has already embarked on the award procedure.⁵³

Under the Services Directive⁵⁴ the authority may employ the competitive negotiated procedure if it is not capable of drawing up specifications with sufficient precision. As it has to be examined below in greater detail,⁵⁵ mere difficulties in drawing up the project specification are not sufficient to satisfy the strict requirements developed by the Court of Justice.

As we have seen for the open and restricted procedure, the uncertainty in the context of pre-tender negotiations is primarily related to the question of how to satisfy the requirements of transparency and equal treatment rather than to the question of applying the rules contained in the Directives.⁵⁶ Insofar as the principles are applicable to both standard procedures, the situation coincides with that under the competitive negotiated procedure. Authorities which employ the negotiated procedure are not required to draw up specifications, since a tender phase is not required. If awarding authorities decide to draw up specifications, they should publish a PIN before

⁵⁰ For example: European Commission, op.cit., note 59 of ch.3, para 3.15.

⁵¹ Case 199/85 *Commission v. Italy* [1987] E.C.R. 1039, para 14 of the judgment; Case 328/92 *Commission v Spain* [1994] E.C.R. I-1569; Case 57/94 *Commission v Italy*, judgment of May 18, 1995 (unreported).

⁵² Utilities have the free choice between open, restricted and negotiated procedure.

⁵³ Arrowsmith, op.cit., note 24 of ch.5, p.69.

⁵⁴ Article 11(2)(c) Services Directive.

⁵⁵ Krüger, "The Scope for Post-Tender Negotiations in International Tendering Procedures" in: Arrowsmith/Davies op.cit., note 64 of ch.5, p.184.

⁵⁶ Arrowsmith, op.cit., note 24 of ch.5, p.69.

conducting pre-tender negotiations. This is to satisfy the requirements arising from the principles of transparency and equal treatment.

5.2. *Post-tender negotiations*

It is inherent to the PFI approach that the public sector harvests as many ideas and experiences as possible from the private sector on how to deliver the public service in a more economically viable way. Hence, one favourable precondition for a successful PFI project is the scope for innovation in design which enables the service provider to design away risks and bring new ideas to the way the service is provided.⁵⁷ Considering the ongoing input stream from prospective contractors, negotiations with prospective suppliers may occur after it has been established who is interested in the particular contract.

The use of post-tender consultations is unproblematic where the competitive negotiated procedure is employed. Even in the negotiated procedure it ought to be paramount for the authority to ensure that the prospective providers are treated equally. This includes that bidders must be given equal opportunity to negotiate issues with the authority. Further, every tenderer should be given the opportunity to amend their tenders when this is made necessary by the outcome of the negotiations. Thereby, an objective comparison of the bids submitted shall be ensured.⁵⁸

Conversely, when one of the two standard procedures is used it is doubtful whether contracting authorities are permitted to embark on post-tender negotiations with those bidders who respond or those which it has shortlisted.⁵⁹

5.2.1. Possibility of conducting post-tender negotiations

As in the case of pre-tender negotiations, the Directives are silent in respect of the question of whether it is permissible to conduct post-tender negotiations.

⁵⁷ H.M. Treasury, op.cit., note 8 of ch.2, p.14.

⁵⁸ Cf. Case C-243/89 *Commission v. Denmark* [1993] E.C.R. I-3353, para 37 of the judgment.

⁵⁹ Arrowsmith, op.cit., note 24 of ch.5, p.67.

5.2.1.1. *Systematic argument*

It has been mentioned in the introductory chapter on the European procurement rules that awarding authorities are vested with the free choice between open and restricted procedure. To employ the negotiated procedure is only permissible where certain narrowly construed derogations are satisfied. To allow post-tender negotiations in open and restricted procedure would imply that those standard procedures became quasi-negotiated procedures by blurring the line between them.⁶⁰ This line is distinctly drawn in the Directives.

From a systematic point of view, one can perceive an apparent difference between the three procedures as regards transparency and competition. The open procedure requires that any contractor with an interest is automatically entitled to tender in response to the notice. When they employ the restricted procedure, authorities are permitted to perform a less transparent screening of prospective tenderers and their bids before inviting them to tender. The additional selection process decreases the degree of competition and transparency. The third and last stage of the anticlimax is the negotiated procedure where the authority selects potential contractors with whom to negotiate, and awards the contract to one of these firms without necessarily following a formal tendering procedure. Due to the freedom to conduct negotiations, this procedure is less transparent than the two standard procedures. It is therefore inextricably linked to the satisfaction of certain requirements.

The existence of three distinctive award procedures⁶¹ and their different degrees of competition and transparency reveal that from a systematic viewpoint negotiations should only be used in the exceptional circumstances provided for in the Directives.⁶²

⁶⁰ Similarly: Arrowsmith, *op.cit.*, note 2 of ch.1, p.247.

⁶¹ Arrowsmith, *op.cit.*, note 2 of ch.1, p.249.

⁶² Cf. Council, "Statement concerning Article 7(4) of Council Directive 93/37/EEC of 14 June 1993 concerning the coordination of procedures for the award of public works contracts" [1994] O.J. L 111/114.

5.2.1.2. *Teleological argument*

Having regard to the *telos* of the procurement rules, it is advocated that they aim at promoting transparent and non-discriminatory procurement policies in Europe. The Council aims to achieve these principles by designing the negotiated procedure as an exceptional procedure to the two standard tender procedures. In particular, the principle of transparency is paramount to the understanding of the European procurement rules.⁶³ It primarily aims to combat preferential treatment of national firms and discriminatory procurement practices within the European Union. From this conception it can be assumed that the decision-making process should only be based on the submitted tender bids alone. The final bid should be in the form of a final “take it or leave it” irrevocable tender.⁶⁴ It should not form the basis for further negotiations on quantities to be delivered, unit pricing, contract conditions and other substantial aspects.

In respect to conducting post-tender negotiations in one of the two standard procedures, the European legislator clearly favours a strict understanding of the transparency and equal treatment principles.

The Council, seized a number of opportunities in recent years to emphasise “that in open and restricted procedures all negotiation with candidates ... on fundamental aspects of contracts, variations in which are likely to distort competition, and in particular on prices, shall be ruled out...”⁶⁵ Albeit the fact that these statements are not legally binding, they can and have been referred to as guidance in interpreting the

⁶³ What has been subject to consistent criticism in the literature, cf. on the delicate balance of the procurement principles “transparency” and “value for money” see: Arrowsmith/Linarelli/Wallace, *Regulating Public Procurement* (2000), p.73 ff.

⁶⁴ Krüger, “The Scope for Post-Tender Negotiations in International Tendering Procedures” in Arrowsmith/Davies *Public Procurement: Global Revolution* (1998), chapter 10 at p.184.

⁶⁵ European Commission and Council: Statement concerning Article 5 (4) of Directive 71/305/EEC, [1989] OJ L 210/22; Statement concerning Article 15 of Directive 90/531/EEC, [1990] O.J. L 297/48; Statement concerning Article 7 (4) of Council Directive 93/37/EEC, [1994] O.J. L 111/114.

regulatory aims and purposes of the legislator.⁶⁶ On the grounds of the guidance notes it can be assumed that the legislator considers open and restricted procedure as the standard procedures, which do not allow for negotiations on substantial aspects during the award process in contrast to the exceptional negotiated procedure. This interpretation is underpinned by the consistent jurisprudence of the Court regarding the exceptionality of negotiated procedure⁶⁷ from which it can be inferred that negotiations⁶⁸ *per se* are thought to be an exception.

It is submitted in the literature that these statements are ambiguous and do not entirely rule out negotiations.⁶⁹ Authors argue that if the equality principle is observed and all firms that have not yet been excluded from the procedure are given the same opportunity to adjust their submitted bids, post-tender negotiations are at least not outlawed. Following this line of argumentation would mean that it is not required to conduct open and the restricted procedure as inconvenient “paper procedures.”

5.2.2. Scope of post-tender negotiations

The systematic and teleological interpretation of the procedural rules and the principles underlying the Directives have shown that the legal situation regarding post-tender negotiations is one of uncertainty. If one adopts the view that post-tender negotiations are legitimate under certain conditions, it has to be asked in a next step, what issues might be made subject to discussions without infringing the existing procedural rules and, in particular, the underlying principles.

Negotiations on substantial aspects of the contract, which have a distorting

⁶⁶ Advocate General Tesauro in Case C-243/89 *Commission v. Denmark* [1993] E.C.R. I-3353, para 19 of the Opinion.

⁶⁷ Case 199/85 *Commission v Italy* [1987] E.C.R. 1039, at para 14; Case 328/92 *Commission v Spain* [1994] E.C.R. I-1569; Case 57/94 *Commission v Italy* judgment of May 18, 1995 (unreported); Case 24/91 *Commission v. Spain* [1992] E.C.R. I-1989.

⁶⁸ At least in the form of the non-competitive type of the negotiated procedure.

⁶⁹ For example: Krüger, “The Scope for Post-Tender Negotiations in International Tendering Procedures” in Arrowsmith/Davies, op.cit., note 64, chapter 10.

effect on competition are not permitted under the two standard procedures.⁷⁰

This means in the Commission's wording that discussion may only be held with candidates "for the purpose of clarifying or supplementing the content of their tenders or the requirements of the contracting entities, and provided this does not involve discrimination."⁷¹

Nevertheless, the Council and the Commission avoid defining precisely what is meant by "substantiality." This lack of precision creates another regulatory lacuna regarding the actual scope of permitted negotiations. The Council and the Commission specify in their statement⁷² that the purchaser may not be permitted to enter into negotiations on aspects of the bid relevant to its evaluation, in particular, its price. One can ascertain that tenderers should be allowed to amend their bids if this results in making it less competitive.⁷³

*Where inconsistencies occur in the bid, such as calculation errors, it has to be asked,⁷⁴ whether the clerical error was obvious to the authority on the face of the bid. Hence, if the authority is able to ascertain the exact nature and cause of the calculation error, the bidder should be provided with the opportunity to rectify its mistake. In *Adia Interim*,⁷⁵ the ECJ held that a contracting authority is not under a duty to allow rectification of a "not particular obvious systematical calculation error." This means, conversely, that the Directives do not confer a right to the tenderer to amend its bid. In this case, the Court considered the principle of equal treatment as being impaired, if the contractor is granted the opportunity to adjust other factors, such as the profit margin, whilst rectifying the error.⁷⁶ It can be assumed from this judgment that there is a "ban on substantial amendments" in open*

⁷⁰ Arrowsmith, op.cit., note 2 of ch.1, p.249; in greater detail regarding the subjects of permissible discussions: Arrowsmith, op.cit., note 53, p.69-70.

⁷¹ Council/ European Commission, *Statement concerning Article 7 (4) of Council Directive 93/37/EEC*, [1994] Official Journal L 111/114.

⁷² *Ibid.*

⁷³ Arrowsmith, op.cit., note 2 of ch.1, p.248-249.

⁷⁴ Case T-19/95 *Adia Interim S.A. v. European Communities* [1996] E.C.R. II-321.

⁷⁵ *Ibid.*

⁷⁶ *Ibid.*, para 47 of the judgment.

and restricted procedure.

The decisive question would be whether the bidder could seize the opportunity of correcting the unsubstantial error for adjusting more substantial parts of the bid after submission. In the later “Walloon Buses” case,⁷⁷ the Court of Justice failed to seize the opportunity to render an obiter dictum on whether the procuring entity could allow all bidders to revise their offers. The Court held that the principle of equal treatment was breached if only one bidder was given the opportunity to substantially amend its bid without giving the same opportunity to other bidders too.⁷⁸

A similar rule can be applied where bids are submitted, which are per se non-compliant with the project specifications. They may be formulated in the wrong language or the prices may not be quoted in required currency. In that case, the tenderer should be allowed to rectify the bid if the divergence can be easily and transparently corrected.⁷⁹ If it becomes necessary to provide additional information to render the bid compliant, the bidder could use the opportunity to make its bid more competitive.

In each of those cases, it must be paramount for the authority to adhere strictly to the principles of equal treatment and transparency as developed in the “Storebaelt”⁸⁰ and “Walloon Buses” cases.⁸¹ This means, in particular, that if one tenderer is granted with the opportunity to correct its bid, other tenderers must be provided with the same chance.

5.2.3 The Agreement on Government Procurement

This interpretation can be upheld even for authorities included in the scope of the General Agreement on Government Procurement (GPA),⁸² although it

⁷⁷ Case 87/94 *Commission v. Belgium* [1996] E.C.R. I-2043.

⁷⁸ Para 67 of the judgment.

⁷⁹ Arrowsmith, op., cit., note 53, p.70.

⁸⁰ Case C-243/89 *Commission v. Denmark* [1993] E.C.R. I-3353.

⁸¹ Case 87/94 *Commission v. Belgium* [1996] E.C.R. I-2043.

⁸² For further reference: Hoekman/Mavroidis, “Basic Elements of the Agreement on Government Procurement” in: Hoekman/Mavroidis, *Law and Policy of Public Purchasing*

does not correspond with Article XIV (1)(a) of the GPA. This rule provides authorities with the general opportunity to conduct post-tender negotiations, if this was indicated in the contract notice. The right to conduct post-tender negotiations derives exclusively from the GPA and not from the public procurement Directives. The latter do not apply for suppliers from signatories of the GPA. The European Directives deal exclusively with the relations between the contracting entities of the European Union and companies established there. They are consequently the only legal sources applicable to the relation between E.U. contracting authority and E.U. supplier. The GPA does not amend these relationships. Hence, in respect of post-tender negotiations it is impossible for E.U. authorities to evade the stricter European rules on post-tender negotiations in favour of Article XIV (1)(a) GPA.⁸³

5.3. Empirical findings

The issues involved in conducting pre- and post-tender negotiations under the two standard procedures are not very pertinent for PFI practitioners, because most PFIs are procured under the negotiated procedure. With respect to pre-tender negotiations it can be concluded from an outsider perspective that as long as authorities placed a PIN, the PFI procurement practice was compatible with the requirements of procurement law.

PubSA#7 commented that it was undoubtedly very difficult to bring one of those projects into fruition without using the negotiated procedure. She did not perceive the employment of the restricted procedure without any post award negotiations as a viable alternative. Though those questions may not seem relevant to many practitioners, it is submitted that this situation may change. PubSA#9 identified the

(1997), p.13-30; Brown/Pouncey, "Expanding the International Market for Public Procurement: the WTO's Agreement on Government Procurement" (1995) *Int.T.L.Rev.*, p.69; de Graaf/Trepte, "The Revised GATT Procurement Agreement" (1994) *P.P.L.R.* CS70.

⁸³ For a more detailed examination of the relationship between the E.C. Directives and the GPA see: Arrowsmith, op.cit., note 2 of ch.1, p. 781-782.

reasoned opinion of the Commission against the U.K. in the *Pimlico* case⁸⁴ and the progressing standardisation of projects as making it more difficult for authorities to justify the application of the negotiated procedure. Both developments might force authorities to employ the restricted procedure more often in PFI. If the practitioners' reflections on the recent developments are correct, considering the extent to which negotiations are permissible under the restricted procedure will become increasingly pertinent.

BothSA#1 reported that post-award negotiations posed a significant and frequent problem. The negotiations occurred although the contractor no longer faced the competitive pressure of fellow tenderers.⁸⁵ BothSA#1 acknowledged the problem and knew that his clients might be challenged on this decision. It would be almost impossible to prove in the post-award stage that the negotiations distorted competition or violated procurement rules.⁸⁶

⁸⁴ “Pimlico” case, European Commission, (2000) *Single Market News* No.23 (October).

⁸⁵ BothSA#1.

⁸⁶ BothSA#1.

Chapter 6 *Changes to specifications*

6.1. Introduction

The European procurement Directives and the U.K. Regulations oblige contracting authorities to specify in the general or contractual documents the technical specifications with which the goods and services to be procured must comply.¹

6.2. Changes to specifications – the legal problems

6.2.1. Definition of “specification”

“Technical specifications” means the totality of the technical requirements contained in the contract documents, defining the characteristics required of a material, product or supply, permitting a material, a product or a service to be described in a manner such that it fulfils the use for which it is intended by the authority letting the contract.²

The European Directives and the U.K. Regulations require that technical requirements shall include levels of quality, performance, safety or dimensions, including the requirements applicable to the material, the product or the service as regards quality assurance, terminology, testing and test methods, packaging, marking or labelling. They shall also include rules relating to design and costing, the text, inspection and acceptance conditions for works, and methods or techniques or construction and all other technical conditions which contracting authority is in a position to prescribe in general or specific Regulations, in relation to the finished works and to the materials or parts which they involve.³

6.2.2. Output specifications

In a PFI situation, specifications will typically not be drawn up with reference to the asset, but rather in terms of service delivery.⁴ The specifications will determine for

¹ Works Regulation 8(1), Works Directive, Annex III, Supply Regulation 8(1), Supply Directive, Annex III, Services Regulation 8(1); Services Directive Annex II.

² *Ibidem*.

³ European Commission, *Guide to the Community Rules on Public Services Contracts*, p.43.

⁴ H.M. Treasury, *op.cit.*, note 86 of ch.2, p.4.

instance, that road users need a safe and reliable crossing, not a particular kind of tunnel or bridge construction. As the specifications are only drafted in output terms, bidders have greater freedom to decide how the service is provided.⁵ The “output-based” approach⁶ to specifications is likely to produce bids that differ markedly in cost, benefit and risk streams and profiles. The differences between the proposed solutions renders it difficult for the authority to choose an evaluation method suitable to take all the variables into account.⁷

It appears possible to conclude from the derogation contained in Article 11(2)(c) of the Services Directive that an initial lack of precision regarding the specifications does not pose legal problems where the negotiated route is used. The derogation expressly permits the use of the negotiated procedure in cases where it is not possible to establish specifications with sufficient provision. Conversely, under open and restricted procedure the specifications cannot be viewed as the mere starting point for further negotiations with bidders. Hence, where the two standard procedures are used, specifications should be drawn up with sufficient precision to be an apt basis for the submission of formal bids.

6.2.3. Changing specifications

During the course of the procurement process, or during the execution stages of the contract, a PFI procuring entity may want to change the specifications of the project on matters which were referred to in the contract notice.⁸ Changing the specifications might become inevitable owing to an extension of the contractual term, an addition of related services or an alteration of the conditions of delivery. Changes or substantial amendments to the initially advertised contract are not a rare occurrence when procuring PFI schemes. In the first four major road projects, for example,

⁵ H.M. Treasury, op.cit., note 154 of ch.2, para 2.2.

⁶ H.M. Treasury, *Writing an output-based Specification* (1996).

⁷ H.M. Treasury, op.cit., note 4 of ch.2, p.32. (Northern Line).

⁸ Arrowsmith, "Amendments to Specifications under the European Public Procurement Directives" (1997) *P.P.L.R.* p.128.

bidders proposed more than 3000 amendments to the original specifications.⁹ It has to be noted that only a small number of those proposed amendments resulted in subsequent changes to the project specifications. The main reason for amendments or changes to the specifications was that in the past authorities drew up specifications too rigid and too prescriptive instead of adopting an output-based approach.

One should not lose sight of the fact that harvesting innovative proposals is key to achieve value for money in PFI contracts.¹⁰ It is possible to distinguish the innovative suggestions of bidders according to their compatibility with the original project specifications. While many suggestions will only entail amendments of the project which are compatible with the output specification, others will make suggestions to achieve the stated output in a different way. Suggestions falling within the latter category are usually referred to as “variations” or “alternatives.”¹¹ If an authority is poised to take variations into account, it has to state this possibility in the contract documents.¹² It should also be aware that such a variation differs *per definitionem* from the solution specified in the contract documents and *per se* generally triggers a change in the project specification

The following section therefore examines the question of whether altering the project specifications during the procurement process is reconcilable with the European Directives. It is noteworthy that the findings will apply irrespective of the fact of whether the government department employs the open, restricted or competitive negotiated procedure.

6.2.3.1. Changes between contract advertisement and the submission of bids

It is PFI procurement practice that project specifications which are initially

⁹ NAO, *op.cit.*, note 40 of ch.2, p.3.

¹⁰ Select Committee on Public Accounts, *The Contract to develop and update the replacement national insurance recording system*, 46th Report (June 1998), p.2.

¹¹ See Arrowsmith, *op.cit.*, note 2 of ch.1, p.618-619.

¹² Works Regulation 20(4), Article 19 Works Directive; Supply Regulation 21(4), Article 16(1) Supply Directive; Services Regulation 21(4), Article 24(1) Services Directive; Utilities Regulation 21(4), Article 34(3) Utilities Directive.

drafted in fairly broad terms are further refined by consulting the market before the formal advertisement of the contract notice in the OJEC. Once the project's specifications are advertised, they establish the basis for the whole bidding process.¹³ Potential contractors will base their decision of whether to prepare a bid proposal for the project on the specifications contained in the contract notice and the related contract documents. What then is the position, if the authority wishes to make changes to the project specifications once the contract has been advertised by means of a contract notice in the Official Journal of the European Communities but before the deadline for submission of bids?

It is arguable that changes to the specifications establish a new basis for the submission of formal bids. In essence, the authority awards a "new" contract which differs in its basic requirements from the initial contract notice. It appears possible to submit that if the authority awards a "new" contract it ought to terminate the current award procedure and commence a new advertisement process in the Official Journal.

It is questionable whether even inconsequential changes to the contract specifications should trigger a new contract award procedure. It is suggested in the academic literature,¹⁴ in U.K. case law¹⁵ and by the Commission¹⁶ that the contract should be re-advertised only in the case of "significant" or "material" changes to the project requirements. Changes should be considered as "material" if the altered contract could have attracted market participants which were not interested in the original arrangement. This could be the case if the authority advertises a contract for the supply of a fleet of 200 cars over a five year period and subsequently wishes to add a maintenance element to the already advertised contract. The addition of 10 additional cars does not amount to a "material" change that would render a re-

¹³ Albeit it is not expressly stated in the Directives, this is clear from the function of the specifications in the procurement process, cf. Arrowsmith, *op.cit.*, note 2 of ch.1, p. 614.

¹⁴ Arrowsmith, *op.cit.*, note 8 of ch.6, p.128.

¹⁵ *R. v. Portsmouth City Council, ex parte Peter Coles and Colwick Builders*, Court of Appeal, judgment of November 8, 1996.

¹⁶ European Commission, *op.cit.*, note 24 of ch.3, p.11.

advertisement of the arrangement indispensable. As there are no expressive provisions in the Directives on changes to specifications, it becomes necessary to examine in the following whether the suggested solution is reconcilable with the principles underlying the Directives.¹⁷

The first principle worthwhile to be examined in this context is the principle of proportionality, which is not only underlying the procurement Directives but is held by the European Court of Justice as being part of the general principles of community law.¹⁸ It requires that any measure taken by the public entity should be both necessary and appropriate in the light of the objectives sought.¹⁹ A measure is considered to be “necessary” if it reconciles two conflicting interests in a way that the degree of impairment of the one interest for the sake of the other does not exceed what is deemed to be justifiable.²⁰ This principle is also referred to as the “principle of the least possible impairment.”²¹

The conflicting interests are the interests of potential participants of the bidding process and the interests of the contracting authority in an adequately flexible procurement procedure. It can be assumed that contractors which did not respond to the original contract notice are not interested in a contract which is only slightly amended after its OJEC advertisement. Hence, the interest of the authority and the participating tenderers in a swift procurement procedure prevails over the interests of the not further consulted market. Where “material” changes to the specification occur and other firms in the market might be interested in the changed contract, the principles of equal treatment and transparency and the interests of the potentially interested contractor succeed. It can be assumed that this solution achieves an appropriate balance between the bureaucratic burden imposed on contracting

¹⁷ See above section 3.3.3.

¹⁸ Case 265/87 *Schröder* [1989] E.C.R. at p. 2237, para 21 of the judgment.

¹⁹ Case T-260/94 *Air Inter SA*, judgment of the Court of First Instance of 19 June 1997.

²⁰ Cf. for example: Case 122/78 *Buitoni* [1979] E.C.R. 677, para 16 of the judgment; Case 66/82 *Fromançais* [1983] E.C.R. 395, para 8 of the judgment; Case 15/83 *Denkavit Nederland* [1984] E.C.R. I-2171, para 25 of the judgment.

²¹ Larenz, *Methodenlehre der Rechtswissenschaft* (1992), p.300.

authorities by the Directives whilst at the same time ensuring that the objectives of transparency and equal treatment are not prejudiced.²²

Secondly, it appears questionable whether the suggested balance of interest is reconcilable with the principle of equal treatment. The latter implies that any person who sought, seek or would have wished to tender for a government contract has the same chances to learn about opportunities and to formulate the terms of their offers.²³ The equality principle requires that similar situations are to be treated equally unless the discrimination is justified by objective reasons.²⁴ A viable objective reason for justification is that any persons who sought, seek or would have wish to tender for a government contract is not prejudiced.

In the case of slight amendments to the specifications it is advocated that the changed contract is unlikely to attract tenderers different from those which responded to the original advertisement. Although tenderers which responded to the original advertisement are treated differently from those which did not, the discrimination is objectively justified. Where specifications are only slightly amended, the principle of equal treatment is therefore not impaired if contracting authorities do not re-advertise the contract.

In situations where the contract is materially changed, other suppliers might have been interested to participate in the award procedure. Hence, if the authority decides not to advertise the “new” contract, it unjustifiably prejudices those bidders which were not interested in the original arrangement. Consequently, this impairment of the equal treatment principle is not justified by an objective reason. It is submitted that the principle of equal treatment obliges the authority to re-advertise any materially changed contractual arrangement.

Although the treatment of changed specifications is not expressly dealt with in

²² Arrowsmith, op.cit., note 8 of ch.6, p.129.

²³ Case 87/94 *Commission v. Belgium* “Walloon Buses” [1996] E.C.R. I-2043, para 54 of the judgment.

²⁴ Case 810/79 *Überschär*, judgment of October 8, 1980.

the Directives, it is possible to argue that an analogy with a derogation for the use of the negotiated procedure supports the solution suggested. Each public sector Directive contains the provision that the contracting authority may use the negotiated procedure without an advertisement if a contract notice does not attract tenders or the tenders received are irregular or submitted by unqualified bidders. This applies on the condition that the contractual arrangement remains “substantially” unaltered.²⁵ Thus, the public sector Directives stipulate that contracting authorities may proceed without advertisement if the changes made to the original arrangement were unsubstantial in nature. The same principle may apply when deciding whether to allow an authority to proceed without advertisement in a case where the procedure has not failed.²⁶

The analysis suggests that probably only material changes to the contract specification, meaning changes with the potential to attract other bidders, ought to be advertised in the OJEC anew. In analogy with the Directives’ rules on time limits, all bidders should probably be provided with an extension to the usual time limits for amending their proposals according to the new requirements.

If substantial changes to the specifications occur, some bidders might be no longer interested or capable of upholding their tenders and may withdraw from the tender process. This might be the case where the delivery and operation of an IT system is added to a contract and the consortium is not able to subcontract this newly appended part of the project to an IT specialist. In this case, the procuring department must amend its shortlist so as to meet the minimum number of tenderers required for “genuine competition” in the procedure.²⁷

The Directives expressly provide that the number of candidates admitted to negotiate may not be less than three²⁸ and the number considered as ensuring genuine

²⁵ Article 6(2) Directive 93/36; Article 7(2) Directive 93/37; Article 11(2) Directive 92/50.

²⁶ Arrowsmith, *op.cit.*, note 8 of ch.6, p.130.

²⁷ Case 27/98 *Metalmecanica Fracasso v. Amt der Salzburger Landesregierung*, [1999] E.C.R. I-5697 (ECJ), para 27 of the judgment; with comments: Dischendorfer, (2000) *P.P.L.R.*, CS159.

²⁸ For example: Article 22(3) Works Directive 93/37.

competition in the restricted procedure is five.²⁹

6.2.3.2. *Changes after contract advertisement and deadline of submission of bids*

Once the deadline for the submission of tenders has expired, non-material changes to the specifications should be arguably permitted. This applies under the condition that the contracting authority honours the transparency of the procurement process and the equality of the participating tenderers. The latter must be given the opportunity to submit amended formal bids based on the new specifications and an appropriate time period for the revision.³⁰

6.2.3.3. *Changes after contract award*

Finally, changes to the scope of the contract might arise after the contract has been awarded or even after it has been concluded.

Arguably, the Directives do not bar post-award changes as long as they decrease the overall price of the arrangement or increase the contractual obligations of the bidder without a compensating reimbursement.³¹ Under both circumstances, the parties to the awarded contract do not favour the private sector contractor.

Conversely, changes to the specifications which include an increase in the price paid by the authority or favour the winning bidder, provide ample scope to abuse the procurement process to the disadvantage of other bidders. The “favourite bidder” could, for example, submit a tender which is artificially low priced, on the basis of the understanding that it will be provided with the opportunity to raise the price once the contract has been awarded. The PFI scheme for replacing the national insurance recording system (NISR2) may serve as a good example how the private sector contractor can influence the contract specification in the post-award phase in its favour. Andersen Consulting lowered in the final round of negotiations its overall price from £242 million to £134 million, thus undercutting its own indicating bid price

²⁹ For example: Article 22(2) Works Directive 93/37.

³⁰ Arrowsmith, op.cit., note 8 of ch.6, p.133.

³¹ *Ibid.*, p.134.

by £108 million and the final bid prices of its two remaining competitors by £80 million and £101 million respectively.³² Irrespective of the question of whether the £134 million bid should have been considered by the Contributions Agency as “abnormally low” within the meaning of the Directives,³³ the winning contractor approached the Agency few months after the PFI contract was concluded to revise the implementation timetable of the project.³⁴ The time schedule formed an essential part of the original specifications of the project due to the underlying legislative timetable.³⁵

In practice, the public sector authority at this stage of the project has not many options to choose from. It can either re-start the procurement process from scratch or accept the proposed amendments to the contract. The first alternative is *de facto* not available, since advertising the contract anew is too onerous and time consuming³⁶ in view of the public demand for implementing the service.³⁷ This provides the private sector contractor with a considerable leverage to achieve favourable changes to the specifications.

There are mainly three possibilities of how to deal with the problem of post-award changes to project specification.

The first possibility could be to allow changes to the scope of the contract which increases the price or reduces the contractor’s obligations only in situations where the Directives expressly provides for such negotiations with an existing contractor. The grounds provided for in the Directives are where a purchase of supplies from the original supplier is necessary as to avoid technical incompatibility or disproportionate

³² Select Committee on Public Accounts, op.cit., note 10, para 19, table 1.

³³ Article 27 Supply Directive 93/36; Article 37 Services Directive 92/50; Article 30(4) Works Directive 93/37; there are good arguments in favour of this assumption in the given case, cf. Committee of Public Accounts, op.cit., note 10, para 23.

³⁴ This has caused the particular concern of the auditors: Select Committee on Public Accounts, op.cit., note 10, paras 6, 7(iv).

³⁵ Select Committee on Public Accounts, op.cit., note 176 of ch.2, para 28.

³⁶ The empirical data collected verified this assumption, cf. section 6.2.3.1.

³⁷ This goes in particular for such highly sensitive projects such as the passport agency or the national insurance recording system, cf. “Computing - an explosive mixture,” *Financial Times*, 22 July 1999.

technical difficulties or where certain works and services are a repetition of those under the original contract. Finally, under Works and Services Directives, negotiations with an existing provider are permitted where the additional lot cannot be separated from the original contract for technical reasons.³⁸ Under all three public sector Directives it might additionally be possible to invoke the “extreme urgency” derogation where the justifying circumstances are not attributable to the contracting authority and the situation was unforeseen.

Arguably, the grounds contained in the Directives are the only justification for amending the specifications of the original contract and even slight changes to the original contract need to be advertised if not one of the grounds is satisfied. The better argument observes the principle of proportionality. Accordingly, imposing an obligation on contracting authorities to re-advertise the contractual arrangement even for slight, but unjustified, amendments,³⁹ unreasonably increases the transaction costs for bidders and authorities.

A second solution would be to render only de minimis changes permissible, these are minor adjustments well below a 10% increase of the contract volume. This solution could prove beneficial in large scale construction projects where it is inevitable to amend slightly the original project specifications.⁴⁰

A third option is based on the general principles underlying the Directives. It would allow non-material amendments to the specifications. Changes on matters not required to be included in the contract notice would accordingly be permissible without re-advertising the arrangement. In following this broad interpretative approach, the provisions contained in the Directives would be applicable only in cases of “material changes.” Kerr J. implied in *Portsmouth* that the “material” requirement

³⁸ Articles 6(2) Directive 93/36; Article 7(2) Directive 93/37; Article 11(2) Directive 92/50.

³⁹ Even slight amendments will be covered by the public sector rules in any instance, since the “aggregation rules” are inevitably applicable to such arrangements: Articles 5 Directive 93/36; Article 6 Directive 93/37; Article 7 Directive 92/50.

⁴⁰ The 10% figure was suggested by Professor Arrowsmith in “PFI Contracts under the European Rules,” a presentation given as part of the *Public Procurement and PFI Seminar*, London (Treasury Solicitor), 22nd September 1999.

could also be applied as “the contract progresses” and, hence, becomes applicable at all stages of the contract award process.

Albeit the last of the three possibilities gives ample scope for manoeuvre, which might be beneficial from a commercial point of view, it seems difficult to reconcile it with the rules of the Directives and their underlying principles. In order to safeguard against abuse during the post-award phase it is of utmost importance to ensure that the changes made to the specifications after the contract has been awarded do not exceed a very limited extent. Otherwise, the contracting parties would be able to collude to the detriment of the other participants in the procedure. Such practices would impair the equality and transparency principles and the procedural rules laid down in the Directives. If one further considers the existing grounds contained in the Directives, it is even more questionable whether European Court of Justice will be inclined to adopt the suggested *de minimis*, although this may offer an appropriate balance between the interests involved. On the one hand it allows for minor adjustments and hence for some commercial flexibility and safeguards on the other hand the rights of the other bidders.

6.2.4. Analysis

In drawing the conclusion it is possible to maintain that the rules on specifications contained in the Directives can be held to be the most significant hurdle for conducting post-tender discussions on substantial issues. This applies even if the authority employs the negotiated procedure.

Changes to the contract specifications can be deemed as an essential, though problematic tool for contracting authorities to consider innovative solutions brought forward by tenderers. We have seen that harvesting innovations with respect to the design, construction and management of the asset is an essential source of ensuring value for money in PFI schemes. It is submitted that there is a general divergence between procurement law and the PFI procurement practice. While the first requires that the awarded contract has to be consistent with the terms of its original

advertisement in the OJEC, the latter requires ample scope for innovative input from the bidders. This divergence underlines the particular relevance of the legal problem for the PFI procurement practice.

Taken together the findings suggest that in open, restricted and competitive negotiated procedure it seems permissible to change the specifications where the changes relate to matters not referred to in the contract notice. Furthermore it can be argued that changes are permissible where they relate to matters referred to in the contract notice but the changes are not material in that they would not have caused additional bidders to respond to the notice had it been re-advertised.⁴¹

When changes occur during the procurement process, the contracting authority should seek to ensure that the principles of equal treatment and transparency are not impaired. This includes that time limits are extended or bidders are added to the shortlist where appropriate. Once the contract has been awarded or is signed with the winning bidder, changes to the specifications are only permissible on the grounds included in the Directives or where they are of *de minimis* nature.

6.3. Empirical findings

The participants in the study suggested that changes to the project specifications were a frequent occurrence in PFI.⁴² PrivSA#6 mentioned authorities were inclined to change the specifications due to reasons not directly related to the procurement process, such as planning permissions or technology changes.⁴³ He outlined that the procurement of the project may take up to two years and technology especially in the IT sectors was changing constantly. For this reason, adjustments to the specifications did occur quite regularly because authorities did not want to lock the project in to the market condition of two years ago, but wanted an up-to-date product.⁴⁴

⁴¹ Arrowsmith, op.cit., note 8 of ch.6, p.136.

⁴² Every respondent.

⁴³ PrivSA#6.

⁴⁴ PrivSA#6.

Other reasons for changing or amending the specifications came up in the course of the procurement process, for instance during the negotiations with bidders. BothSA#1 remarked that amending and refining the specifications was “a natural part of the negotiation process.”⁴⁵ PubSA#9 stated that if negotiations meant anything then the parties had not only to negotiate about price but exactly about what was going to be delivered. Thus, the level of detail of the specifications increased in the course of the negotiations.⁴⁶ She described this iterative process as “reactive.”

PubSA#4 portrayed the occurrences that services either “dropped out or were taken on board”⁴⁷ as legitimate.⁴⁸ They were inherent to the PFI procurement process. She said it was one major principle of PFI to rely on the skills of the private sector to design and deliver projects.⁴⁹ BothSA#3 added that this did not cause concern under the procurement rules if the project specifications were published in output terms.⁵⁰ Output specifications were said to decrease the risk that “substantial” changes occurred which required the re-advertisement of the contract.

BothSA#3 mentioned further that the level of detail of the specifications varied depending on whether the project has been advertised under the works or services regime. Whilst the former remained largely input driven, the latter were rather output driven.⁵¹ In the latter instance, he concluded that although the specifications seemed to be “jelly-like” and “services were jumping in and out,” technically there were no changes to the specifications due to the use of output specifications. PubS#3 agreed and outlined that it depended on how the project was structured from the beginning. If the authority used broad outline specifications and the authority would work out later in the process what those headings meant in detail, it was probably not changing its mind.

⁴⁵ BothSA#1.

⁴⁶ PubSA#9.

⁴⁷ PubSA#10.

⁴⁸ PubSA#4.

⁴⁹ PrivSA#6.

⁵⁰ BothSA#3.

⁵¹ BothSA#3.

PubSA#8 agreed in essence that changes to the specifications were to a certain degree inherent to PFI. She added they were also partly due to “the frustrating problem” that the public authorities were not always very clear about what they actually wanted.⁵²

As a result of a substantial change in specifications in the course of the award procedure, authorities might be obliged to re-advertise the contract so as to give suppliers the opportunity to bid for the changed contract. PubSA#8 endorsed the view that for the authority to come under this obligation, the changes to the contract must be substantial. She described the changes made to PFI contracts as not so substantial as to require to re-start the whole procurement from scratch, but as not insignificant either.⁵³ Two lawyers encountered projects, where the specifications have been undoubtedly amended in a “substantial” manner.⁵⁴ Others, such as PrivSA#6, remarked that services were “dropping out and coming in all the time.” PubSA#4 stated that a strict application of the procurement rule in the area of specifications would stifle the negotiation process, since it would then be necessary to re-advertise the contract all the time. “The project would simply not get through.”⁵⁵

Although the question of “substantiality” was clearly a matter of degree, PubSA#4 gained the impression that due to the definitive timescale constraints standing against the option of re-advertising the whole project, starting from scratch was not a realistic proposition for most PFIs.⁵⁶ BothSA#6 gave the example of a health project which was substantially changed by effectively doubling the amount of works and services to be delivered. Even in this case, where the goal posts moved with the effect that the bidders “were bidding essentially for a different project,”⁵⁷ the option of re-advertising was dismissed as too time and cost-consuming.

⁵² PubSA#8.

⁵³ PubSA#8.

⁵⁴ For confidentiality reasons it is impossible to name the projects or the authorities.

⁵⁵ PubSA#4.

⁵⁶ PubSA#4.

⁵⁷ BothSA#2.

6.4. Conclusion

It was expected that the problem of whether it is permissible to change or amend the specifications was perceived by legal advisors as being of practical relevance. This was clearly not the case. Legal advisors experienced the issue as not pertinent to their practice. They unequivocally stated that even where the goalposts were moved substantially during the negotiations, authorities failed to consider re-advertising the contract.

The demand of public procurement law to re-advertise substantially changed contracts is deemed as unworkable in PFI, where the specifications are developed during the procurement process. In this context, practitioners perceived the law as a serious obstacle to a swift and convenient PFI procurement process. So-called “pragmatic” considerations, such as convenience and swift procedures, prevail over the theoretical knowledge of the legal problems involved.⁵⁸ This perception explains why the application of procurement law is not considered and the law’s impact on the legal practice is severely limited.

Procurement law is build on the presumption that public contracts should be tendered and not freely negotiated. The European legislator views tendering procedures as a pertinent means to warrant transparency and competition. Tendering procedures are build on definitive specifications against which the tenderers bid. In PFI, the project specifications are developed within a negotiation process. What is more, the outline specifications are treated in PFI merely as a starting point for further discussions with bidders. The specifications are therefore altered and refined throughout the bidding process as bidders propose more innovative ways of delivering the public service required. It is therefore possible to conclude a fundamental discrepancy between the law and the legal practice regarding the perception of specifications in the bidding process.

⁵⁸ This occurrence may be an overarching issue which will be dealt with further below.

What is more, the procurement rules are built on the proposition that the procurement is concluded within a relatively short period of time. This is obviously not the case with PFI projects. The empirical study has shown that negotiations can take up to five or six years in some IT contracts. Within this period, technology is likely to change and so are probably in some cases the needs of the authority. Both aspects may require amendments or even changes to the project specifications which may be of substantial nature. It is possible to conclude a discrepancy between the requirements of the legal practice and procurement law which compromised the impact of procurement law on PFI procurement practice.

Chapter 7 Classification of transactions

7.1. Introduction

Another legal uncertainty is the question of whether PPP contracts are regulated by the Works, Supply or Services Regulations. The answer depends on the subject matter of the contracts involved and is often far from straightforward.¹

7.2. Classification of transactions – the legal problems

To classify PFIs it is necessary, firstly, to define and, secondly, to distinguish the different Regulations that may be applicable. Finally, it has to be analysed whether PFI projects are concession contracts and what the consequences would be of employing these specific rules. The public procurement regime distinguishes between three types of contracts, these are works, supplies and services.

7.2.1. Works contracts

Works contracts are concerned with (1) the carrying out of “works” or “a work,” or (2) the procurement of a work “by any means.” In this context, “work” means “the outcome of any works, which is sufficient of itself to fulfil an economic and technical function,” while “works” is defined as any of the activities specified in Schedule 1 of the Works Regulations. This Schedule is based on the outdated NACE classification of activities, which is now mainly replaced by the community’s own Community Product Classification (CPC). Following the Schedule of Directive and Regulations, building works, for example construction of flats, office blocks and hospitals, and civil engineering, including construction of roads, bridges, railways, etc., are included in the definition of “works.” The second arm of the definition, procurement of works “by any means,” brings within the works rules any arrangement whereby the authority draws up a specification for a work, and the contractor is entrusted with the task of providing it.²

Many PFI projects involve building works, as for instance the contract for a new

¹ Fox/Tott, op.cit., note 5 of ch.2, at para 3.2.5.

² Arrowsmith, op.cit., note 2 of ch.1, p. 129.

hospital, or civil engineering, as in the case of a toll bridge. This “works” element in PFI projects may justify the application of the Works Regulations.

7.2.2. Supply contracts

Public supply contracts, within the meaning of the European Directive and implementing U.K. Regulations, are contracts for “(a) ...the purchase of goods by a contracting authority ... or (b) for the hire of goods by a contracting authority (both where the contracting authority becomes the owner of the goods after the end of the period of hire and where it does not) and for any siting or installation of those goods...”³ It follows from this definition that even if the private contractor of the PFI transfers the assets after several years of exploitation, the public authority acquires these assets in for the purposes of the Supply Regulations. A good example is the PFI procurement of new trains (“train availability”)⁴ for the Northern Line by London Underground.

7.2.3. Services contracts

Public services contracts are agreements “under which a contracting authority engages a person to provide services.”⁵ In contrast to works and supply contracts, which generally come within the ambit of the respective procurement Regulations, the coverage of services may be described as fragmentary. The EU Directive subdivides services with a genuine potential for cross-border competition into two separate parts. Part A services listed in Schedule 1 of the Public Services Contracts Regulations 1993 (“Part A services”) are entirely subject to the rules. This includes maintenance and repair, computer services, management consultancy and so forth. Services listed in part B of Schedule 1 (“Part B services”) are only subject to certain technical specifications and post-award notices but exempt from all other procedural requirements. Hotel and restaurant services, rail and water transport, and health and

³ Art. 2 (1) “public supply contract” Supply Reg.

⁴ H.M. Treasury, op.cit., note 4 of ch.2, p.32.

⁵ Art. 2 (1) “public services contract” Services Reg.

social services are good examples of Part B services. As with the Schedule for works contracts, the Annex for Services refers to the CPC which defines the various categories in more detail. In contrast to the Works Regulations, the regulatory regime for services (and supplies) encompasses rules for contracts of indefinite duration. In the view of the Treasury, a PFI proposal will usually fall within the definition of a services contract.⁶ This is a “natural consequence”⁷ of the emphasis the PFI places on “outputs” rather than “inputs.” The public sector acquires services rather than works or goods, even with financially free-standing projects and joint ventures.

7.2.4. Relevance

The procurement Regulations clearly envisage that authorities decide on the classification of their contracts, since the application of one Regulation excludes all other Regulations' applicability.⁸ A contract is therefore either for works, supplies, or services. It is for this reason that authorities have to decide on a case-by-case basis how to classify each PFI. This classification may have repercussions throughout the procurement process, because of the remaining differences⁹ between the three public sector Directives.

At the beginning of the procurement process, the PFI contract usually has to be advertised in the Official Journal (OJEC). One somewhat technical reason for having to distinguish between different contract types is that the OJEC designates different advertisement sections for works and services contracts. It may be regarded as a substantive breach of the rules if, for example, an invitation to tender for “works” was advertised in the “services” section only and was therefore not recognised by a potential bidder searching only in the “works” section. It could be argued that twin-track advertisements of PFI opportunities do not compromise the transparency and equal opportunity principles underlying the publication requirement. If a contract is

⁶ H.M. Treasury/ Private Finance Panel, op.cit., note 46 of ch.2, p.31.

⁷ Chave/Dees, op.cit., note 23 of ch.5, p.58.

⁸ Read, op.cit., note 158 of ch.2, p.188.

⁹ The fact of remaining differences between the "public sector" rules is subject to criticism: cf. Arrowsmith, op.cit., note 2 of ch.1.

published in the works and services sections of the OJEC, neither construction companies nor service providers will miss an opportunity to submit bids. It is questionable whether this practice is compatible with the procurement Directives which envisage the categorisation. Presumably for this reason, the Official Journal has sent some of the advertisements back by return and demanded a precise classification of the PFI scheme. In addition, it is submitted that the precise taxonomy of each PFI contract is pertinent for six reasons arising from differences between the three public sector Directives.

A significant difference between the three sets of Regulations is the threshold values above which each Regulation applies. Whereas the threshold value for works contracts is ECU 5,000,000 (equalling £3,370,00),¹⁰ the contract's value under the Supply or Services Regulations has to exceed only ECU 200,000 (£134,800).¹¹ Improper reliance on these provisions may easily result in a breach of the rules. If, for example, the awarding authority mistakenly assumes that a services PFI contract is one for works, it will not advertise this contract in the OJEC when its value does not exceed £3,370,000.

To date, most PFI projects have exceeded the ECU 5,000,000 threshold so that this significant difference between the two Directives did not cause practical difficulties. This may change when local governments begin to utilise PFIs as procurement tool on a more regular basis. This development, actively supported by the Labour government,¹² is likely to result in more PFI contracts falling below the ECU 5,000,000 threshold of the Works Directive.¹³ In these cases, the different value thresholds of works and Services Directives compel the procuring authority to decide whether the contract is to be classified as one for works or, alternatively, for services.

Another issue of vital practical importance for the awarding authority, is the

¹⁰ Works Directive, art 3 (1).

¹¹ Supply Directive, art 5 (1); Services Directive, art 7 (1).

¹² DETR, *op.cit.*, note 9 of ch.2.

¹³ For example: Victoria Dock Primary School in Kingston upon Hull with a capital value of £2 mio.

question whether or not in the specific case it is entitled to utilise the competitive negotiated procedure. Without going into details, one can assert that the general rule of the public sector regime is that authorities must use the open or the restricted procedure.¹⁴

Employing the competitive negotiated procedure is linked with the fulfilment of certain grounds that allow derogating from the rather strict open and restricted procedures. The public sector rules still contain different derogations justifying the application of the competitive negotiated procedure. The Services Directive and the Works Directive, but not the Supply Directive, permit recourse to the competitive negotiated procedure where either the nature of the work or service or the risk attaching to performance are such as not to permit overall pricing.¹⁵ Additionally, the Services Directive, but neither of the other two, may apply when the “nature of the services ... is such that contract specifications cannot be established with sufficient precision to permit the award of the contract by selecting the best tender according to the rules governing open or restricted procedure.”¹⁶

What is more, the PFI project may be more correctly classified as a concession contracts. Recall that concessions are defined as agreements under which the consideration given by the contracting authority consists of, or includes the grant of, the right to exploit the works to be carried out under the contract.¹⁷ The European procurement regime catches only public works concessions, meaning that if the concession contract is one for services it falls outside the procurement rules altogether. This issue will be dealt with in greater detail below.

The fourth reason for insisting on the proper classification of PFI projects is that the Services Regulations exclude certain services entirely,¹⁸ for example contracts related to land, and exclude other services partly from the regime, so-called “Part B”

¹⁴ See above section 3.3.2.1.

¹⁵ Services Directive, art 11 (2) (b); Works Directive, art 7 (1) (c).

¹⁶ Services Directive, art 11 (2) (c).

¹⁷ Works Directive, art 1 (d).

¹⁸ Services Directive, art 1 (a) (i) - (ix).

or “non-priority” services, including hotel and restaurant, legal, education services. These exceptions are unique to the Services regime.

The public sector Regulations differ in another detail, which is of some importance in relation to PFI projects, regarding the method for calculating the thresholds for contracts of indefinite duration. Where the contract is of an indefinite duration, or for more than four years, the Services Directive, but neither the Works nor the Supply Directive, requires¹⁹ the value of the contract to be ascertained by multiplying the expected monthly value of payments by forty-eight. This rule is of considerable importance in the context of PFI where a contractual duration of 15 or 20 years is common.

Finally, advertisements placed by authorities may be made subject to challenges by unsuccessful bidders and then it may be held by courts to be insufficient that the contractual award procedure complied with only one set of Regulations. In the circumstances of challenges, it may be crucial which of the three public sector Directives is to be applied.

It is possible to conclude that for the six reasons that the question of classifying PFI contracts is far from merely “academic.”

7.2.5. Treatment of mixed contracts

It is one major rationale of Public Private Partnerships to integrate the construction and services elements of a project that is to create efficiency gains and synergies.²⁰ PFI contracts can be therefore characterised as “multi-faceted contracts,”²¹ in the sense that they comprise more than one of the contractual elements previously discussed. One example would be a hospital PFI that may comprise the erection of a new hospital building *and* the delivery of contracted “medical services.” The combination of several elements in one contract renders it difficult to classify a PFI

¹⁹ Services Directive, art 7 (5).

²⁰ Arrowsmith (ed.), op.cit., note 24 of ch.2, para 8.029

²¹ Fox/Tott, op.cit., note 5 of ch.2, at para 3.2.7.

agreement applying the criteria laid down in the procurement Directives. The E.C. rules were initially developed for contracts with only one predominant purpose, such as the building of a conventionally financed hospital (works), the acquisition of office materials (supply) or the provision of legal advice (services).

The U.K. Treasury recommends that PFI proposals should be classified in terms of a service requirement²² with an output-based specification.²³ Defining the contract in terms of services will usually bring PFI contracts within the realm of the Services Directive. In the case of a contract for a new hospital, the awarding NHS Trust may have contracted for a specific number of hospital beds and may have approved the plans for the construction. Yet, its primary interest is in the provision of medical services, not building construction.²⁴

Any construction or renovation of a hospital clearly contains “works” included in the definition of the Works Regulations,²⁵ and the purchase of medical equipment may also be caught by the Supply Regulations. Support services, such as cleaning, security or catering for the hospital, would fall within the ambit of the Services Regulations. Thus, “the characterisation of a PFI proposal as a ‘service provision’ does not imply that it will automatically be classified as a service contract under the EC rules. It is feasible that a PFI project could be structured as a long-term service provision but still be a works or a supply contract.”²⁶

7.2.5.1. Mixed supply/ services contracts

The public sector Regulations provide rules in order to deal with multi-faceted contracts, which combine elements of supplies and services contracts. Article 2 (1) of the Supply Regulations²⁷ expressly provides that the contract in question shall only be

²² H.M. Treasury, Treasury Taskforce, *Technical Note 2 - How to follow EC Procurement Procedure and Advertise in the OJEC* (1998).

²³ H.M. Treasury/Private Finance Panel, op.cit., note 46 of ch.2, p.31.

²⁴ Skilbeck, “The Private Finance Initiative and Public Procurement,” (1996) *P.P.L.R.* p.148, at p.149.

²⁵ At least in case of an asset transfer at the end of the concession period.

²⁶ H.M. Treasury, Treasury Taskforce, op.cit., note 22, para 2.3.1.

²⁷ Article 2 Services Directive.

a public supply contract “...where the value of the consideration attributable to the goods and any siting or installation of the goods is equal to or greater than the value attributable to the services.” The contracting authority, having regard to this Article of the Supply Regulations, has to assess the *relative value* of each contractual element which then leads to the determination of the applicable set of Regulations. One example is the PFI project “Northern Line” which is concerned not only with the provision of new trains (design and manufacture) but also with the maintenance and cleaning both of trains and associated trackside equipment.²⁸ In this project, the outcome of the inherently complex *relative value* assessment has been that the value of the trains is greater than the value of the related maintenance services which have to be performed during the contract's term. Therefore, the contract is included in the scope of the Supply Regulations.

7.2.5.2. Mixed works/ services and works/ supply contracts

Whilst mixed supply/ services contracts are subject to explicit legal Regulation, the classification of mixed works/ services and mixed works/ supply contracts was not made subject to any Regulation. The distinction between works and services contracts is probably the most important in the context of PFI since infrastructure projects consist of works plus the award of a concession to exploit the completed work as consideration. One example would be a contract for the erection of a bridge coupled with a concession to levy tolls from end users. Three possible tests to classify mixed contracts can be identified, these are the greater value-test, the severability-test and the main objective-test.

The valuation approach adopted by the Supply Regulations was advocated in the past by the European Commission²⁹ as a means of determining the treatment of

²⁸ H.M. Treasury, Private Finance Panel, op.cit., note 46 of ch.2, p.32.

²⁹ European Commission, *Guide to the Community Rules on Open Government Procurement*, OJ [1987] C358; *Public Procurement and Community Financing* OJ [1989] C22.

contracts for both works and supplies.³⁰ This is another application of the *relative value* test of the elements involved in the contract just described.

The European Court of Justice did not choose the valuation approach but developed in Case C-3/88 *Commission v Italy* [1989] E.C.R. 4035 (“Re: Data-Processing”) a test involving the severability of the contractual elements. An Italian government department had advertised a contract for a data processing system which involved both the supply of hardware and the provision of associated services. The Court held that the hardware could have been procured separately from related services and, therefore, ruled that the effect of combining both elements within a single contract was to bring the whole contract within the scope of the Supply Directive.

It has to be noted that the Services Directive was at the relevant time not in force, so the Court only considered the question whether the contract as a whole was brought within the realm of the Supply Directive. It did not examine the potential overlap between the two Directives. The notion of severability was employed by Advocate-General Lenz in Case C-331/92 *Gestion Hotelera Internacional v Comunidad Autonoma de Canarias* [1994] E.C.R. 1329 (“Gestion Hotelera”) to differentiate the area of application of two Directives. The case was concerned with a two-fold invitation to tender issued by a Spanish regional authority. The authority initially indicated its intention to award a concession to install and operate a casino; secondly, it advertised the operation of a publicly owned hotel business. Both elements required certain works to be carried out in advance of their opening and were linked in such a way that both had to be performed by the same entity.

The Advocate-General reached the conclusion that the works element could not have been severed without altering the contract's legal structure³¹ since it was the authority's intention that the building works should be carried out by the company “in

³⁰ Services were not regulated until 1993.

³¹ Para 40 of the opinion.

the framework of its [broader] obligations.”³² Two factors were decisive in Mr. Lenz’s opinion³³ that the works contract would not be considered in isolation, namely that the authority did not draw up detailed specifications for the work and gave no prospect of payment for the work.

In a “typical” PFI project both scenarios are conceivable. The works to be carried out may have an own economic function and may be regarded as an independent contract or may, alternatively, be secondary, perhaps a necessary prerequisite, in view of other more dominant contractual obligations. In considering again the Treasury’s statements concerning the general perception of PFIs as a “new way of procuring new things,”³⁴ the contracting authority will normally not intend “to award a works contract on its own account, but to find a company which would have the building works carried out in the framework of its obligation to the authority.”³⁵ There may be a presumption in favour of regarding the works carried out in the course of a PFI as not being severable and as incidental to the framework agreement. This is then properly classified as a services contract.

The European Court of Justice rejected the severability approach taken in *Re Data Processing* and suggested by Advocate-General Lenz when deciding the *Gestion Hotelera* case. The judges developed instead the “main objective” test which seeks to determine the authority’s primary intention and the “predominant purpose”³⁶ of the contract. If the authority intended to award a works contract on its own account, the purpose of the contract is obviously one for works, whereas if the works were to be carried out in the framework of a broader contractual obligation to the authority, the contract is essentially one for services. The ECJ held in *Gestion Hotelera* that the “main object of the award of the contract was, first, the installation and opening of a

³² *Ibidem*.

³³ Case C-331/92 *Gestion Hotelera Internacional v Comunidad Autonoma de Canarias* [1994] E.C.R. I-1329, Opinion of Advocate General Lenz, para 41 at p. 1340.

³⁴ Read, *op.cit.*, note 158 of ch.2, p.189.

³⁵ Opinion of Advocate-General Lenz, *op.cit.*, note 33, para 40, at p. 1340.

³⁶ H.M. Treasury, Private Finance Panel, *op.cit.*, note 46 of ch.2, p.31.

casino and, secondly, the operation of a hotel business. It is common ground that those contracts, considered as such, do not fall within the scope of the [Works Directive].”³⁷ The rationale for this “common ground” can be deduced from the sixteenth recital of the Services Directive, stating that when “works are *incidental* rather than the object of the contract, they do not justify treating the contract as a public works contract.” In order to ascertain whether contractual elements are the *main object* of the contract or merely *incidental*, the ECJ developed in the *Gestión*- Case three principal criteria of relevance. “... First, that the documents mentioned above [specifications] did not contain any description of the subject-matter of the works to be carried out ..., secondly, that there was no provision for remuneration for those works and thirdly, that the successful tenderer was not in a position to carry them out itself.”³⁸

The three relevant factors therefore appear to be (1) the extent of details of the specifications concerning the works to be performed, (2) the provisions for remuneration and (3) whether the tenderer could carry out the works itself.

In applying the Court's criteria to a “typical PFI project,” one can, firstly, assert that the specifications of the PFI will not be drawn in great detail. The fact that specifications are rather designed in broad terms results mainly from the requirement not to stifle more innovative solutions that might be brought forward by the private sector tenderer. Open specifications are certainly also the consequence of an “output-based” approach to specifications,³⁹ which is *per se* not as prescriptive as “normal contracts” for acquiring clearly defined goods and services. The specification in the contract notice to be published in the Community's Official Journal must be written with a certain degree of detail regarding the expected works. Otherwise the awarding authority may come up against interested parties who claim that all or part of the project has not been accurately advertised.

³⁷ Case C-331/92 *Gestión Hotelera* [1994] E.C.R. I-1342, para 23 of the judgment.

³⁸ *Ibidem*, para 24 of the judgment.

³⁹ H.M. Treasury, Private Finance Panel, *op.cit.*, note 46 of ch.2, p.32.

With regard to the second relevant factor, the provision for remuneration, the Court ascertains that the payment of a lump sum indicates the award of a works contract while remuneration by periodic payments points to the existence of a contract for services. It is likely that the project company in a “typical PFI project,” apart from financially free standing ones, will be remunerated for carrying out the project. Hence, the payment usually takes the form of periodic payments relating to the provision of the service⁴⁰ rather than a lump-sum payment designed to cover capital building costs. This form of remuneration guarantees the effective transfer of the building risk to the private sector entity. It also shows that the assumed “typical PFI” contract may more suitably be characterised as a services contract according to the “remuneration criterion.”

However, this criterion does not reflect modern financing practices. Lump-sum payment for large-scale infrastructure projects, even if not procured through PPP, is becoming rare. Secondly, it can be argued that the payment mechanism should not have repercussions for the classification of the contract. The assumed relationship is hardly invariable, as authorities pay for their works contracts also by means of periodical payments. Those contracts do not necessarily include an element of services. On the basis of this assumption, the Highway Agency procured its PFI motorway projects under the Works Directive, even though the contracts included substantial service components.⁴¹

Under the final limb of the “main object” test, it should be considered whether the tenderer is able to carry out the work by itself or if it is necessary to employ third parties to perform the awarded contract. The Court's purpose in establishing this criterion was that if the private sector company does not perform the works itself, it may more properly be viewed as a service provider from the authority's perspective. It should be noted that the judgment was based on Council Directive 71/305 before it

⁴⁰ cf. Thomas, *op.cit.*, note 119 of ch.2, p.521.

⁴¹ Highway Agency, *op.cit.*, note 16 of ch.2, para 4.4.

was amended by Directive 89/440.⁴² This is significant, since the ECJ could not take into account that the Works Directive includes the procurement of a work “by any means.” This term expressly provides authorities with the opportunity to appoint providers to let contracts as agents on their behalf. Thus, considering the current legislative framework, the court's third criterion seems doubtful.

In comparing the three approaches taken it has to be pointed out that all of them lack the precision to provide awarding authorities and tenderers with appropriate legal certainty. Furthermore, as Advocate-General Lenz relied on the same criteria (detail of specifications, provision of remuneration) in exercising the severability-test as the Court in its main object-test, their practical effect may be similar. The possibility remains that the Court could adopt the alternative relative value approach.⁴³

7.2.6. Application of the concession rules

Once the authority has classified the PFI as being either works or services, the question has to be addressed whether the rules on concessions are applicable. As we have seen in chapter 3, contracts classified as works concessions are regulated under the Works Directive only in a very limited way involving requirements to advertise the concession. Neither the Utilities nor the Services or Supply Directives contain express regulation of concession contracts and it is submitted that those types of concessions are not covered by the directives at all. As we have seen,⁴⁴ there may probably be limited obligations such as a requirement to advertise under the E.C. Treaty.

Only the Works Directive includes a definition of concession contracts.⁴⁵ The distinct feature⁴⁶ of a concession is that the private sector contractor is awarded the right to exploit the delivered asset instead of being reimbursed by a lump sum for delivering works, services or goods. “Exploitation” in this context means that the

⁴² Case C-331/92 *Gestion Hotelera* [1994] E.C.R. I-1342, at para 17.

⁴³ Digings/Bennett, op.cit., note 2 of ch.1, D2/20.

⁴⁴ At para 2.3.3.5.

⁴⁵ Article 1(d).

⁴⁶ Case 272/91 *"Italian Lottery"/ "Lottomatica"* [1992] E.C.R. I-457; [1992] E.C.R. I-3929

private sector provider will recover its incurred costs directly from public users instead of charging the awarding authority.⁴⁷ Hence where the concessionaire receives payments from public users the contract is not a concession but rather a service contract.⁴⁸ It is submitted that in a situation where a concessionaire builds government accommodation and is reimbursed by

The Commission further specifies in its *Draft Interpretative Communication on Concessions*⁴⁹ that another element of the definition of “exploitation” is that the “contractor assumes a significant part of the risks in the management and use of the facilities.”⁵⁰ The Commission emphasises that even though the Directives do not expressly deal with other forms of partnerships, this does not imply that they are generally exempt from the rules and principles of the E.C. Treaty. As many of these concession-type partnerships can be defined as “acts of State” in the broadest sense, they are, according to the Commission, subject to Articles 43 and 49 E.C. Treaty and the fundamental principles derived from them by the Court of Justice.⁵¹ This view is highly contentious.⁵²

7.2.6.1. Works concessions

The Works Directive and its implementing U.K. Regulations regard public works concession as a distinct category of contract, the “works” being the exploited asset.

The rules for concessions laid down by the Works Regulations are perceived as much less onerous in comparison with those for ordinary works contracts. The awarding authority has to comply only with the procedural obligation to publish its “intention” of awarding the concession by means of a notice in the Official Journal,⁵³

⁴⁷ H.M. Treasury, Private Finance Panel, op.cit., note 46 of ch.2, p.31.

⁴⁸ Arrowsmith (ed.), op.cit., note 24 of ch.2, para 8.041.

⁴⁹ European Commission, op.cit., note 24 of ch.3.

⁵⁰ *Ibid.*, at para 1.1; this view is supported by Advocate General Pergola in C-369/96 *Gemeente Arnhem v. BFI*, (1998) E.C.R. I-6821, para 26 of the opinion.

⁵¹ See above section 3.3.3.

⁵² Braun, op.cit., note 116 of ch.3, p.39.

⁵³ Works Directive, art 11(3).

allowing at least 52 days for receipt of tenders.⁵⁴ The firm or consortium awarded the concession is itself obliged to publish a notice in the OJEC publishing the award of any works sub-contracts exceeding the value of ECU 5,000,000. The private works concessionaire may fix a time limit that is not less than 37 days for participation requests and 40 days for the receipt of tenders.⁵⁵ There are no further procedural restrictions imposed on the concessionaire or the awarding authority and, in particular, there are no constraints set on how the tendering procedure should be conducted thereafter.

PFI projects are in some cases not dissimilar to concessions⁵⁶ in the sense that the awarding authority is to a certain degree privatising the duty to provide “works” to the public. It is therefore not surprising that a number of PFI projects have been categorised as works concessions, including the Channel Tunnel Rail Link and the Skye, Second Severn and Dartford QE2 bridges. These types of PFI projects generally give the private sector contractor the incentive of being able to charge private users directly for the service or construction which they provide, for example, by levying toll on users of the completed bridge, in exchange for carrying out the works and bearing the risks of the transaction. Conversely, where the private consortium is to be remunerated for a project agreement only through shadow tolls, these are periodic payments by government based on traffic usage, it is rather an agreement for services than a concession because the right to charge tolls from the end user is not vested in the consortium.⁵⁷

The public authority awarding a PFI as concession agreement is largely exempted from the general obligation to comply with the rigid procedural requirements and, in particular, from the obligation to make the project subject to the various competitive processes set down in the procurement rules. This exemption from competitive

⁵⁴ Works Directive, art 15; Works Regulations, art 25.

⁵⁵ Works Directive, art 16; Works Regulations, art 26.

⁵⁶ Skilbeck, *op.cit.*, note 24, p.155.

⁵⁷ Arrowsmith (ed.), *op.cit.*, note 24 of ch.2, paras 8.043-46.

tendering procedures stands in contrast to the Treasury's clear commitment to competition as a means of "securing value for money and helping to guard against corruption or the appearance of it."⁵⁸ In order to reap these benefits, the particular PFI project must be subjected to some competitive process even though it may be correctly classified as a public works concession and the public authority does not need, from a legal point of view, to follow the procurement rules.⁵⁹

7.2.6.2. Services concessions

Services concession contracts are contracts under which a purchasing authority engages a private sector entity to provide services and confers the right to exploit the provision of these services to the public by charging the final user. Although the concept of service concession was included in the Directive's first draft in its Article 1(a),⁶⁰ it was subsequently left out of the final text because in some Member States public services concessions are awarded by contract whereas in others they are not. Including provisions for service concessions in the Directive would have led to disequilibrium among states, which would have applied the Directive differently.⁶¹

Services concessions are therefore excluded from the European procurement Directives and from the implementing U.K. Regulations.⁶² It is well settled, for example, that a concession concerning urban cleaning or waste removal services is not covered by the procurement rules where the contractor levies a tariff directly from the end users.

The Commission promotes the application of certain principles embodied in the E.C. Treaty, such as equal treatment, transparency, mutual recognition and proportionality. It considers that these principles require *inter alia* that contracts for services concession should be advertised in advance and that these publications should

⁵⁸ H.M. Treasury, op.cit., note 4 of ch.2, p.40.

⁵⁹ Read, op.cit., note 158 of ch.2, p.188-189.

⁶⁰ Prieß, op.cit., note 2 of ch.1, p. 53.

⁶¹ Read, op.cit., note 158 of ch.2, p.188.

⁶² See Case C-324/98, *Telaustria Verlags GmbH v. Telekom Austria*, judgment of 7 December 2000 (unreported) para 48 of the judgment.

specify the objective selection and award criteria to be employed in auctioning the contract.⁶³ We have seen, that the principles of equal treatment and transparency are not based on the Treaty but were derived from the Court of Justice directly from the procurement Directives.⁶⁴ Hence, it is not possible to derive any positive obligations from the principles which, furthermore, would not be capable of delivering the necessary legal certainty which is much needed by practitioners involved in this field.⁶⁵

It is particularly important in the context of concession to differentiate between contracts for works and those for services, since works concessions are subject to rules in the Directives, whilst services concessions remain completely unregulated. The clear distinction between works, supplies and services contracts as envisaged by the legislator in the procurement Directives is especially difficult to draw in large-scale projects which are supposed to realise synergies by integrating all three elements. The European Commission has advocated that the decisive criterion was whether the contract involves building a structure on behalf of the grantor.⁶⁶ Hence, according to the Commission, concession contracts are included in the scope of the rules on works concessions as far as they exceed the value threshold of ECU 5,000,000 and some kind of construction work is involved. This rule is applicable even if substantial services elements are involved. The effect of this suggestion is that concession contracts, which would be defined as service concessions by applying the greater value or the main objective test, are brought within the ambit of the rules on works concessions.⁶⁷ But that conclusion is not reconcilable with the clear intention of the legislator, which refrained from regulating concessions with a major services element.

The Commission has proposed to change the procurement Directives to bring

⁶³ European Commission, op.cit., note 24 of ch.3, pp.10-13.

⁶⁴ See above section 3.3.3.

⁶⁵ Clark/Norris, "Euro Procurement," (1999) *Supply Management* (15 April) p.42.

⁶⁶ European Commission, op.cit., note 24 of ch.3, para 2.3.

⁶⁷ Arrowsmith (ed.), op.cit., note 24 of ch.2, para 8.029.

services concessions within their ambit.⁶⁸ These amendments are likely to introduce greater legal certainty by clarifying and simplifying the current regulatory situation.

7.2.6.3. Utilities concession

Utilities concessions are neither provided for in the European Utilities Directive nor in the implementing U.K. Utilities Regulations.⁶⁹ It is therefore suggested that, for example, a licence to operate a local tram service where the contractor levies a tariff directly from the end users, does not fall within the realm of the utilities rules.

7.3. Empirical findings

The issues of taxonomy and classification were discussed with some interviewees. Two related matters of controversy addressed were the questions of whether PFIs had to be classified as works or services contracts and whether PFIs came within the realm of the concession rules.⁷⁰

7.3.1. Classification of transaction

When analysing the potential legal uncertainties in the early stages of the research, one of the more obvious uncertainties appeared to be the characterisation of PFI contracts as being either works, supply or services contracts.

Later when drafting the questionnaire, the issue of how to classify PFIs was initially excluded from the catalogue of questions. It was felt that the limited time available for the interviews of 45 to 60 minutes should be spent on discussing more pertinent and complex issues causing greater legal uncertainty. The problem of taxonomy and classification has been exhaustively dealt within Treasury guidance notes and was thus considered to be settled in PFI practice so as not to pose serious difficulties.

⁶⁸ European Commission, op.cit., note 24 of ch.3, p.7, footnote 9.

⁶⁹ Similar to services concession, the European Commission included utilities concessions in its first draft of the Utilities Directive, OJ 1989 C 264, p. 22. This provision was not adopted by the Council, point 10 of document No 5250/90 ADD 1 of 22 March 1990, entitled "Statement of reasons of the Council."

⁷⁰ PrivSA#6.

However, it was one outcome of the necessarily iterative research process that this presumption proved to be unfounded. Although not addressed in the questionnaire, seven interviewees⁷¹ identified the question of classification under the procurement rules as one of the fundamental problems in PFI procurement.

The fact that almost one third of the respondents mentioned the problem area without being expressly asked was one of the surprising discoveries of the research and justifies its incorporation into the research. It seems that at least some lawyers continue to consider the issues involved on a regular basis, regardless of the fact that the Treasury guidance strongly recommends the “automatic” classification of PFIs as contracts for services.

What is more, there is considerable evidence that those lawyers who mentioned the issue and assessed its implications on a regular basis, did not endorse the Treasury’s view. BothSA#3, for example, started from precisely the opposite assumptions, “all the facility projects are works, not services.” He added that

“you go with the flow at the end of the day. And if central government says what you are doing is services notwithstanding the definition, then we say it’s services to keep them happy.”

This statement suggests that lawyers gave advice against their better judgment for the sake of not confusing or upsetting their clients by providing advice deviating from central government guidance. It is noteworthy that law firms operate in a highly competitive market and naturally wish to avoid alienating their clients by raising legal problems perceived to be of a purely “academic” nature.⁷²

PubSA#4 adopted a different approach to guard her public sector clients against potential difficulties stemming from the “unfortunate”⁷³ classification issue by advertising projects “twin-tracked.” On a number of occasions, she did not decide on

⁷¹ PrivSA#3; PubSA#10; PubSA#3; PubSA#4; PubSA#7; BothSA#2; BothSA#3.

⁷² PubSA#9.

⁷³ PubSA#3.

how to classify the contract under the rules but instead placed a contract advertisement in the works contract *and* the services contract section of the OJEC. She followed this “belts and braces” practice in spite of her awareness that the Regulations require classification according to which element is predominant.⁷⁴ Other participants considered those twin-tracked contract advertisements as “incoherent with the rules.”⁷⁵ For them, it was “either works or services.”⁷⁶

Although those respondents raising the issue rejected the Treasury’s interpretation lawyers including PubSA#3 were aware of the advantages of applying the Services Directive.⁷⁷ The advantages of the latter included that it provided authorities with an additional ground for using the negotiated procedure.⁷⁸ PubSA#4 said another advantage of using the services regime was the pre-qualification criterion of “ability” which provided authorities with more flexibility when shortlisting bidders.

Taking different positions on the issue of classification, respondents also expressed different perceptions of the significance of the problem. BothSA#3 thought the matter resolved:

“we have gone to Counsel on that 3 or 4 years ago ... but nobody talks about it anymore.”

This view is reflected in statements of other respondents who rated the problem as being only of minor importance.⁷⁹ Fourteen interviewees did not mention it at all. This perception shows that the respondents tend to underestimate the classification issue during their daily practice. It appears doubtful whether the issue of classification can be universally settled once and for all PFI projects, as BothSA#3 suggested.⁸⁰

⁷⁴ PubSA#4.

⁷⁵ BothSA#3; This view is also suggested by practitioners: Bickerstaff, “The Private Finance Initiative: A Legal View” www.twobirds.com/library/infotech/initiative.htm (last accessed 1999); Fox/Tott, note 5 of ch.2, at para 3.2.11.

⁷⁶ BothSA#3.

⁷⁷ PubSA#4; BothSA#2; PubSA#4; BothSA#3; PubSA#9.

⁷⁸ PubSA#4.

⁷⁹ PubSA#3; PubSA#4; PubSA#7; BothSA#2.

⁸⁰ Braun, “Ticking the right box for OJEC” (2000) *PFI Intelligence Bulletin* (3) p.16.

Practising lawyers' failure to appreciate the importance of the issue may reflect a lax attitude towards regulated procurement, a phenomenon to which we shall return.

7.3.2. Application of the concession rules

Half of the lawyers interviewed had no experience in applying the concession rules in the PFI context. The lack of more widespread experience in applying the concession rules may be explained by the fact that the Treasury has always favoured the application of the rules on services contracts over the concession rules.

7.3.2.1. Definition of concession contracts

The Treasury internally promotes that a contract has to be classified as concession if at least 15-20% of its income stream derives from the exploitation element of the contract. Under those circumstances, either the rules for works concessions become applicable, or the contract escapes regulation if it is a services or utilities concession. However, this threshold is not laid down in formal governmental guidance.⁸¹

Only two lawyers with experience in applying the works concession rules within the PFI context supported the adoption of such a comparatively low threshold.⁸² They said that the pre-condition of a "substantial" exploitation could be satisfied even if only 25% of the income stream derive from the exploitation. This percentage could be substantial if, for instance, the contractual arrangement provided extensive minority voting rights.

PrivSA#6 insisted that the Treasury's view was informed partly by the typical financial structure of the PFI arrangements. Lenders were usually not interested in taking the market-risk, that is to say, the risk of demand. Generally, the shareholders of the project company (SPV) bore this important category of risk, which was reflected in their equity investment in the SPV. The equity investment covered not

⁸¹ This threshold was suggested by John Colling, then head of the procurement policy department, H.M. Treasury, during two practitioner seminars in 2000.

⁸² BothSA#1, PrivSA#6.

more than 8-15% of the total project costs. Hence, the typical real amount of exploitation was reflected in the relatively low equity share of the shareholders. Hence, to capture PFI projects with their low equity share within the rules of concession the Treasury wanted to keep the percentage threshold of exploitation as low as possible.

The majority of lawyers experienced with applying the works concession regime within the PFI context felt that the 15-20% threshold was not sufficient to satisfy the criterion of “substantiality” as laid down in the Works Directive.⁸³ They took a rather robust view on what percentage is necessary and generally felt uncomfortable with the Treasury’s figure.⁸⁴ Analogies were drawn with the predominant purpose rules or the greater value rules, where the percentage has to be “significant.” Therefore, PubSA#2 and PubSA#6 felt the exploitation element should exceed 50%.

PubSA#9 advocated a different approach in defining concession contracts. She wanted to look at the risk and reward attached to the project and the economic reality of the project as a whole, irrespective of whether the end-user was a member of the public. She argued it was an accident how the services were delivered and that it did not make any difference whether the charge was coming from the authority or the end-user. Under both circumstances, there may or may not be a sufficient transfer of risk.⁸⁵

Other participants in the study supported the Treasury’s view that PFIs were generally not concession contracts. They insisted that the situation in PFIs was different. The revenue risk was not borne by the contractor because the project agreement generally did not contain an element of exploitation. Projects such as a toll-bridge, where the concessionaire is remunerated by the right to levy the end-users of the asset, were in their experience exceptional in PFI.⁸⁶

⁸³ PubSA#2, PubSA#6.

⁸⁴ PubSA#3.

⁸⁵ PrivSA#6.

⁸⁶ BothSA#1.

7.3.2.2. *Works concessions*

The question arises, why there have not been many more PFI projects awarded under the works concession rules despite the similarities in concept and the advantage that the project is just “lightly” regulated. One reason for this tendency is, as maintained by BothSA#2, “bad experience” in the past with a major international infrastructure project where time and cost slippages occurred.⁸⁷ However, it appears unlikely that the cost and time overruns occurred just because that unique project was advertised as a concession contract.

PubSA#3 gave an example of a works concession, the conversion of a pier. In that case, the responsible authority wanted a contractor to re-build and run a concert venue. Only a small percentage of the project was concerned with office space for the authority. The project company recovered their investment by renting the venue to concert organisers. In this project, a major exploitation element was identifiable, justifying the application of the works concession regime. In the examples given, the exploitation element of the income stream was about 90%. The classification of the contract as concession therefore did not pose difficulties.

A reason why other PFIs have not been equally classified as works concessions may be that the concept of concession is unfamiliar to the U.K. legal system. PubSA#9 described concessions as a “civil law concept”⁸⁸ and remarked that the uncertainties surrounding the parameters of a concession might prove a major obstacle.⁸⁹ PubSA#6 concurred, and added the Commission’s paper on concessions could not diminish the uncertainties.⁹⁰

A further reason why the concession rules have not been used frequently in the past is, as said by PubSA#9, the “political steer from the Treasury to use the negotiated procedure under the Services Directive.”

⁸⁷ Channel Tunnel Rail Link.

⁸⁸ PubSA#9.

⁸⁹ PubSA#9.

⁹⁰ PubSA#6.

Moreover, lawyers found it debatable whether choosing the works concession avenue was good for the project or not. While this simplified the procurement procedure, PrivSA#6 held that it would probably complicate the planning of the sub-contractors. Consortia had to ensure that their members are brought within the “affiliated undertaking” rule with the effect that intra-consortium contracts do not have to be advertised in compliance with procurement law.⁹¹ He insisted that the latter aspect was especially important for private sector consortia.

7.3.2.3. Services concessions

PrivSA#3 argued that many PFIs should have been classified as services concession contracts, thus releasing them entirely from the procurement Regulations. He stated that the concept of services concessions could find application in education and in hospital projects where the majority of the work is not completing the building, but running the school or hospital. PrivSA#3 thought this reflected the balance of value of most of the PFI projects and what the public sector is trying to achieve with them. PFIs were not about building projects, they were arrangements for contracting out the management of an entity. He concluded,

“PFI contracts are not contracts for works, but for services. Consortia are not paid for the services by a lump-sum, but they are enabled to generate income. In all likelihood, the contract has to be classified as a services concession, falling completely outside the procurement rules.”⁹²

Equally, PubSA#9 felt that the concept of concession sat very well with PFI. Especially in the case of more conventional PFIs, where the private sector is bearing risk and reward of the operation of the facility, the commercial reality was comparable to a concession. PubSA#9 mentioned that in these situations, the private sector services providers were at risk.

⁹¹ PrivSA#6.

⁹² PrivSA#3.

Six lawyers advised on projects that were classified either as works or services concessions.⁹³ PubSA#3 mentioned the reception area for a hospital as an example of a PFI services concession. In this project, the hospital was only interested in a reception desk and an IT link to the hospital. Shops occupied the remaining space of the reception area. The authority remunerated the project company by granting the right to commercial exploitation of the reception area by means of renting the space for shops. Despite the fact that the project was a services concession and *per se* outside the procurement regime, the authority advertised the PFI in the OJEC.⁹⁴

In another example, a PFI contract was concerned with running a museum. This contract was, on the word of BothSA#3, not advertised at all. He argued that the decision not to advertise the contract might have been justified. The agreement appeared to be a concession, the granting of a license to run the museum. There were no ongoing payments from the public sector. The concessionaire was granted the right to levy charges to the public end-user instead.⁹⁵

The range of responses and examples is revealing. In the absence of central government advice there seemed to be general uncertainty amongst lawyers. The experience of PubSA#2, who has frequently advised on housing accommodation for staff members, is a case in point. PubSA#2 advised that such a project is not a concession, on the basis that “it does not sit easily with PFI and there were too many legal uncertainties involved.”⁹⁶ She had initially thought that the fact that the occupants were paying rent to the accommodation provider could justify applying the concession rules. In the end she stuck to the well-trodden paths of PFI procurement and advertised the PFI as a regular services contract.⁹⁷

Despite the fact that services concessions are not brought within the realm of the procurement Regulations, three lawyers with experience in dealing with services

⁹³ PrivSA#2; PubSA#3; PubSA#6; PubSA#9; BothSA#2; BothSA#3.

⁹⁴ PubSA#3.

⁹⁵ BothSA#3.

⁹⁶ PubSA#2.

⁹⁷ PubSA#2.

concessions agreed that authorities generally preferred to advertise their projects voluntarily.⁹⁸ PubSA#3 suggested that the authorities were willing to comply with the obligation to advertise PFIs, because they have their own standing orders, their own rules and Regulations obliging them to tender competitively. The authorities viewed advertising under the Regulations as a means to induce the necessary competition and to avoid potential problems that could arise from legal uncertainties.⁹⁹ PrivSA#3 reported a slightly uncomfortable feeling that the rules did not apply, suggesting an extra-legal sense of obligation.

PubSA#6 gave the example of an IT project concerned with the delivery of an IT infrastructure of 20,000 personal computers. Payment was made on a user-charge basis, meaning that the contractor's charges were calculated by multiplying the number of the usable computers with the user charge. As the payment was based on the level of usable infrastructure, the exploitation risk was borne to 100% by the private sector. PubSA#6 advocated that the classification of such a contract as a service concession should not change if the services were provided to the public authority. Although, payment was made by a non-user charge, the significant exploitation element remained recognisable.¹⁰⁰

Although such a contract for a services concession falls *per se* outside the ambit of the procurement Regulations, the public sector authority wished to advertise the contract in the OJEC. This was viewed as a sensible way of commencing the procurement process. PubSA#6 observed that

“people are quite odd. They will press you repeatedly for ways in which they don't have to advertise, for instance where a contract is to be extended. If you give them a quite legitimate route that the rules do not apply, they want to apply them anyway.”

⁹⁸ PubSA#3; PrivSA#3; PubSA#6.

⁹⁹ PubSA#3.

¹⁰⁰ PubSA#6.

It seems that the question of whether to advertise the project or not may not be seriously entertained in PFI. Authorities want to attract a broad pool of interested suppliers and thus generate a sufficient degree of competition. On a more general level, authorities may comply with the procurement rules where regulated procurement has no negative effects on their project.

Chapter 8 The procedural requirements

8.1. Introduction

Public authorities falling within the ambit of the public sector Regulations are under a general duty to award contracts in accordance with three procedures, namely the open, restricted or negotiated procedure. Whereas the use of open and restricted procedure are equal footed, the application of the negotiated procedure is restricted to the fulfilment of certain derogation criteria. The latter may only be employed in “exceptional circumstances”¹ which are laid down in the Regulations.

For procuring an asset using private finance, the open procedure seems inappropriate because every bid has to be considered and, it does not offer the opportunity to restrict (shortlist) the number of bidders. Under the restricted procedure, authorities are permitted to shortlist bidders, but are prohibited from negotiating the contractual terms.

It is for those reasons that lawyers participating in the study perceived the strict application of open and restricted procedure as too cumbersome, especially because they do not permit negotiations between the awarding authority and prospective bidders. Although this restriction is not expressly mentioned in the Regulations, it can be deduced from a joint statement issued by the Council and the Commission.² This statement essentially declares that “in open and restricted procedures all negotiations with candidates or tenderers on fundamental aspects of contracts... shall be ruled out.” Although this statement is not legally binding, it has been employed as a teleological argument to assert that in both standard procedures, it was the legislators' intention to prevent the procuring entity from discussions with tenderers.³

PFI projects consist of a bundle of multi-faceted contracts, which are inherently

¹ Case 199/85 *Commission v. Italy* [1987] E.C.R. 1039, at para 14.

² Statement conc. art. 7 (4) of Council Directive 93/37/EEC, 14th June 1993, OJ [1994] L 111, 114.

³ AG Tesauro in Case C-243/89 *Commission v. Denmark* [1993] E.C.R. I-3353, para 19 of the opinion.

complex to deal with. For this reason it is likely that the need arises during the procurement process to enter into discussion with shortlisted bidders, as part of the process to select the preferred bidder no matter how well the specifications have been drafted. In the legal and contractual area alone, it usually takes months of negotiations to adjust and settle contracts that (a) reflects both parties' wishes, (b) allocate risks correctly and (c) meet Treasury and governmental criteria on the one hand and private sector concerns on the other.⁴

8.2. *Use of the negotiated procedure – the legal problems*

Due to the fact that the restricted procedure is perceived too inflexible to serve as a suitable framework for procuring private financed projects,⁵ many awarding authorities attempt to satisfy one of the grounds so as to derogate from the above outlined rigid procedures. Two types of negotiated procedures have to be distinguished, namely a competitive type that requires the contract to be advertised in the Official Journal and a non-competitive type which does not require a prior advertisement.

The negotiated procedure without advertisement is only permitted on exceptional grounds.⁶ These grounds include circumstances where only one provider can deliver the work, good or service in question due to exclusive rights⁷ or in situations of extreme unforeseen urgency.⁸ It can be expected that these grounds will only arise very rarely in the context of PFI. As this study did not encounter a case where the non-competitive negotiated procedure was applied, it will not be considered further.

8.2.1. *Negotiated procedure with advertisement*

Under the negotiated procedure with advertisement, the contracting authority awards its contract after publication of a contract notice and the selection of

⁴ Morrison/Owen, op.cit., note 71 of ch.2, p.11.

⁵ In the PFI prison projects Bridgend and Fazakerley, the Prison Service started under the restricted procedure but later shifted to the negotiated procedure, Private Finance Panel, op.cit., note 72 of ch.2, para 5.1.

⁶ Services Directive art. 11 (3) (a)-(f).

⁷ Works Regulation 10 (2) (c), Supply Regulation 10 (2) (d), Services Regulation 10 (2) (e).

⁸ Works Regulation 10 (2) (f), Supply Regulation 10 (2) (e), Services Regulation 10 (2) (g).

candidates according to publicly known qualitative criteria.⁹ The three public sector Directives contain different derogations for using the competitive negotiated procedure. In the context of PFI, there are mainly two derogations of interest and importance.¹⁰ These are the “overall pricing” derogation of the Works and Services Directive and the derogation based on the fact that “services cannot be drawn up with sufficient precision” derogation provided in the Services Directive. These are set out further below.

There is, unfortunately, little guidance on the interpretation of both derogations from the European Court of Justice (ECJ). Nevertheless, the Court has decided two important issues as regards to those exceptions. Firstly, they “must be interpreted strictly.”¹¹ Secondly, the “burden of proving the actual existence of exceptional circumstances justifying a derogation lies on the person seeking to rely on those circumstances.”¹²

Both quotations from ECJ case law explicitly prohibit the application of a derogation on a regular basis. Hence, authorities are clearly prevented from using the negotiated procedure automatically when procuring PFIs. It has to be observed that the European Court of Justice established the requirements in cases concerning the application of the negotiated procedure *without* advertisement. It is, therefore, uncertain whether the Court will adopt a similarly strict approach to the competitive negotiated procedure or favours a more flexible approach reflecting the “real commercial need for the use of the negotiated procedure in PPP projects.”¹³

8.2.1.1. “Overall pricing is not possible”

The most pertinent ground to derogate from open and restricted procedure in the

⁹ Works Directive art. 7 (2).

¹⁰ Fox/Tott, op.cit., note 5 of ch.2, at para 3.3.8.

¹¹ Case 199/85 *Commission v Italy* [1987] E.C.R. 1039, para 14 of the judgment; Case 328/92 *Commission v Spain* [1994] E.C.R. I-1569, para 15 of the judgment; AG Lenz in Case 199/85 *Commission v Italy* [1987] E.C.R. 1039, para 32 of the judgment.

¹² Case 199/85 *Commission v Italy* [1987] E.C.R. 1039, para 14 of the judgment; Case 328/92 *Commission v Spain* [1994] E.C.R. I-1569; Case 57/94 *Commission v Italy* judgment of May 18, 1995 (unreported).

¹³ Arrowsmith (ed.), note 24 of ch.2, p.344, at para 9.093.

context of PFI is laid down in the Works and Services Regulations. It determines that a contract may be awarded by the negotiated procedure “exceptionally, when the nature or the [works or services] to be carried out under the contract is such, or the risks attaching thereto are such, as not to permit prior overall pricing.”¹⁴ The meaning of this derogation and the related question of whether it is applicable in PFI are matters of controversy.

The “overall pricing” derogation commences, in contrast to all other derogations, with the term “exceptionally.” This term *expressis verbis* prevents authorities from employing the derogation as a rule in PFI projects.

H.M. Treasury has tried to employ a historical argument by asserting that “the exceptionality attached to this circumstance should not cause concern. “The provision was first included in Article 7(2)(b) of the Works Directive that was negotiated in the 1970s, before the concept of PFI was devised. PFI contracts may well have been considered exceptional at the time the Directive was drafted.”¹⁵ The Treasury concludes “although there are restrictions on the use of this [negotiated] procedure, they are unlikely to prevent its use for most PFI projects.”¹⁶ “It is very likely that most PFI projects will meet the conditions required.”¹⁷

It appears difficult to reconcile the Treasury’s opinion with the wording of the Directives. In fact, the Treasury seeks to turn the exception into the rule. Despite its apparent weakness, the historic argument is widely used and unsurprisingly surfaced in some of the interviews with PFI practitioners.¹⁸ The Treasury’s historic argument disguises that the Directives, which were initially drafted in the early 1970s, have been regularly subjected to amendments,¹⁹ interpreting guidelines²⁰ and communications to

¹⁴ Works Regulations art. 7 (2) (c); Services Regulations art. 11 (2) (b).

¹⁵ H.M. Treasury, Private Finance Panel, op.cit., note 46 of ch.2, p.32.

¹⁶ H.M. Treasury, op.cit., note 4 of ch.2, p.41.

¹⁷ *Ibid.*, p.62.

¹⁸ PubSA#3.

¹⁹ Works Directive 89/440; 93/36; 97/52; cf. the recent proposal to streamline the Directives within which the Commission maintains its strict interpretation: European Commission, *Proposal for a Directive of the European Parliament and of the Council on the*

the Member States.²¹ In all those documents, with the noteworthy exception of its “Public Procurement in the European Union” Communication,²² the Commission interprets the Directives restrictively.

In many of the communications, the “Guardian of the Treaty” complained about the “excessive use of the negotiated procedure.”²³ What is more, the Commission and the Council never showed any inclination to side the Treasury's view that public private partnerships should be considered as exceptional or as coming within the ambit of one of the derogations. Hence, the exceptionality of the overall pricing derogation cannot be dismissed as being a “historical” drafting error of the European legislator.

It has been further argued that PFI schemes were “exceptional” when viewed in the context of procurement in general. PFI schemes were of exceptional complexity and for that reason the exceptionality requirement was generally satisfied. Although the complexity inherent to PFIs distinguishes the projects undoubtedly from normal procurement tasks, it could be argued that the overall pricing derogation was not intended to make the negotiated procedure accessible in the case of “exceptionally complex” projects. This may be concluded from the Commission's proposals to amend the procurement directives published in May 2000.²⁴ Those proposals included a new derogation for the use the competitive negotiated procedure which is expressly based on the assumption that complex procurement tasks should be eligible to use the competitive negotiated procedure. Consequently, if “exceptional” in the overall pricing derogation covered “exceptionally complex” procurements, the proposed amendment would not change the current legal situation.

Even if one accepts the first view, it appears difficult to classify increasingly

coordination of procedures for the award of public supply contracts, public services contracts and public works contracts, 10.5.2000, COM(2000) 275 final.

²⁰ European Commission, *Public Procurement and Community Financing* [1989] Official Journal C22/03, of 28.01.89.

²¹ European Commission, op.cit., note 59 of ch.3.

²² European Commission, op.cit., note 68 of ch.4.

²³ European Commission, op.cit., note 59 of ch.3, paras 3.15-3.16.

²⁴ European Commission, op.cit., note 19.

“standardised” PFI schemes in the health or prison sector as exceptional.

Employing the “overall pricing” derogation is furthermore linked to the requirement that the “nature of the works or services” or the “risks attached” to the project prohibit any prior overall pricing. The question of what the drafters meant by the “nature of the works or services” is a matter of controversy and one can distinguish three interpretative approaches.

The circumstances the Council and the Commission had initially in mind when drafting the Directives were contracts where the risk attached to the performance of the project cannot be properly quantified in advance. The Commission’s interpretation of the term “nature of the works or services” is inspired by projects where the geological conditions are such that it is impossible for bidders to submit an offer with a firm price.²⁵

The Commission gives the example of a tunnel which has to be bored through heterogeneous rocks. Where inconclusive geological surveys do not permit assessing the associated risks and the pricing structure of the tunnel project, the “overall pricing” derogation should be applicable. The example chosen by the Commission further reveals that derogation from open and restricted procedures is only considered acceptable in cases where the risk is immediately attached to the performance of the work or service, thus preventing prior overall pricing. The Commission wants awarding authorities “to show that pricing is impossible since the works are such that no contractor is able to submit an offer with a firm price.”²⁶ This narrow interpretation of the wording underlines the exceptionality of the derogation.²⁷

In most PFIs the uncertainty is not attached to the project itself or its performance. The authority is rather likely to face difficulties in pricing PFI. Those difficulties result from uncertainties over the technical and financial solutions the

²⁵ European Commission, op.cit., note 20, p.61.

²⁶ *Ibid.*

²⁷ European Commission, op.cit., note 19, para 3.2.

tenderers will propose. According to the Commission, such difficulties are not suffice in themselves to justify the application of the overall pricing derogation. Hence it can be argued that the derogation becomes only applicable to PFIs where it is impossible to develop a pricing structure because of uncertainties over performance related issues, such as uncertain geological conditions. If one adopts such a restrictive interpretative approach, the overwhelming majority of PFI projects will fall outside the ambit of the “overall pricing” derogation.

The second, less restrictive, interpretation reads the wording as encompassing situations where there is uncertainty over what bidders will propose to deliver. It is submitted that the derogation is applicable in circumstances where it is unclear what the specifications will be or where the financial and contractual arrangements are uncertain.²⁸

In early PFI projects, such as the first prison contracts, authorities faced difficulties when establishing specifications, scoping the agreement and establishing the pricing mechanisms. This was due to the immense variety of possible payment mechanisms and the uncertainties related to the technical solutions bidders may propose. Those teething problems have already lessened. Over the last couple of years, authorities in the U.K. have become more experienced in scoping projects. In addition, the sheer volume of precedent cases make the individual project less unique. A NHS Trust planning a new PFI hospital these days has access to a plethora of guidelines, standardised contract terms and case studies. Those documents combined with the in-house expertise existent in the NHS eases significantly the difficulties of the respective Trust to scope the project and to draw up specifications.

Similarly detailed guidance notes and standardised contract terms exist for IT and defence contracts and for local government authorities. Under those circumstances it appears possible to anticipate the way in which the need will be met, the risk will be

²⁸ Skilbeck, *op.cit.*, note 24 of ch.7, p.157.

allocated and the cost of tenders that will be returned.²⁹

This interpretative approach may have made the overall pricing derogation applicable to pathfinder PFIs in the early days of the scheme. In those days, PFI awarding authorities were uncertain over what solutions bidders would propose. Nevertheless, it will be difficult to justify the application of this derogation in areas where authorities have gathered some experience and where standardised contract templates are available to them.

The Treasury promotes a third interpretative approach which applies the overall pricing derogation “when at the time the procedure is launched the authority cannot predict the amounts that will be bid.”³⁰ In accepting the Treasury’s view, works or services delivered by PFI projects are “exceptional” because it is uncertain which level of risk bidders are prepared to assume. This uncertainty regarding the level of risk arises from the wide range of possible solutions, such as risk allocation, finance, and prevents the authority from establishing a basis to price the project in advance.³¹ According to the Treasury, this uncertainty triggers automatically the derogation’s applicability and, thus, generally permits to apply the negotiated procedure in PFI.

Accepting the Treasury’s interpretation would make the “exceptional” overall pricing derogation applicable in almost every procurement, not only in PFI. Apart from a small number of “off the shelf” products, the authority is usually uncertain over the amounts the tenderers will bid. Because this interpretation turns the exceptional derogation into a rule, it is incompatible with the wording of the Directives. Therefore, the Treasury’s interpretation has to be dismissed.

From the discussion of the three interpretative approaches it is possible to ascertain, firstly, that the “overall pricing” derogation may only be invoked in exceptional circumstances. The mere use of PFI, as promoted by the Treasury, is *per*

²⁹ Cf. H.M. Treasury, Private Finance Panel, op.cit., note 46 of ch.2, p.31-32.

³⁰ H.M. Treasury, op.cit., note 22, (Technical Note 2).

³¹ H.M. Treasury, Private Finance Panel, op.cit., note 46 of ch.2, p.30.

se not a satisfactory reason for applying the derogation. Without changing the meaning of the Directive, it seems to be impossible to utilise the “overall pricing” derogation on a regular basis for PFI projects. Its regular application would “suggest an entirely different use”³² of the derogation. Irrespective of whether one applies the wide or the restrictive approach to interpreting the “overall pricing” derogation, it will be very difficult to justify its application in the light of the degree of standardisation and experience now prevalent in the U.K.

8.2.1.2. Specification cannot be drawn up with sufficient precision

The negotiated procedure may also apply as per Services Regulation 10(2)(c) “when the nature of the services to be provided... is such that specifications cannot be drawn up with sufficient precision to permit the award of the contract using the open or restricted procedure.”

It is part of the PFI's normal “output-based” award procedure that specifications, which are initially drafted in broad terms, are subsequently refined. As the process proceeds, refinement of the specifications is based *inter alia* on the inputs from the potential providers.³³ Again, the question of how to appropriately allocate risks renders it difficult to draw up specifications which are precise in every circumstance. Therefore, the following section shall examine the circumstances under which it becomes “necessary” to make use of the negotiated procedure.

It is not “necessary” to employ the negotiated procedure if one of the two regular procurement processes is available to the PFI awarding authority. The restricted procedure allows, as the negotiated, the use of broad output specifications against which variant bids may be submitted.³⁴ Moreover, bids may be solicited on alternative basis, for example with or without taking into account a certain risk acceptance. The disadvantage of open and restricted procedure is that both envisage a single

³² Digings/Bennett, op.cit., note 2 of ch.1, D2.12.

³³ H.M. Treasury, op.cit., note 4, p.10.

³⁴ Arrowsmith (ed.), op.cit., note 24 of ch.2, para 9.086.

specification and only one tendering stage.

On a practical level, awarding authorities had to enter into pre-tender negotiations with shortlisted bidders.³⁵ At the end of the pre-tender negotiations, the contracting authority had to define the final technical specifications, either by retaining one of the solutions presented by the participants or by combining one or more of the solutions.³⁶ Once this stage is completed, participants had to submit formal bids against the specification.

If such a process is deemed permissible under the restricted procedure,³⁷ it seems possible for authorities to use the restricted procedure in matured PFI markets. Thus, to justify the use the negotiated procedure for PFI projects on the ground that specifications *cannot* be drawn up otherwise will be become increasingly difficult as PFI markets mature. This goes in particular, as it is insufficient to show that it is more convenient to use the negotiated procedure.

8.2.2. Risk of being challenged

It has been suggested that using the negotiated route in awarding PFI contracts exposes the contracting authority to a lesser risk of being challenged by aggrieved bidders than employing the restricted procedure.³⁸ Entering a discussion process with the authority gives bidders the opportunity to increase their understanding of the authority's needs and thereby to increase the chances to be eventually awarded the contract. Therefore, bidders will appreciate the chance to embark on more detailed discussions and it is unlikely that an aggrieved tenderer considers challenging the contracting authority on this ground.

Additionally, it appears questionable whether the remedy Directives would vest

³⁵ On the question whether this is permissible under the current regime, see chapter 5.

³⁶ Note the similarities with the "dialogue" process which the Commission proposed, European Commission, op.cit., note 19, para 3.8.

³⁷ The Commission believes that "such a dialogue is not allowed under the current open and restricted procedures," European Commission, op.cit., note 19, para 3.2.

³⁸ Arrowsmith, "PFI Contracts under the European Rules," presentation given as part of the *Public Procurement and PFI Seminar*, London (Treasury Solicitors), 22nd September 1999.

the tenderer with an effective remedy against the decision of the authority to employ the negotiated procedure.³⁹ The first possible remedy against any infringement of the procurement rules is to claim damages. It is unlikely that a tenderer suffered damages from the decision under consideration and almost impossible to prove that he suffered a loss or the loss of a chance. Apart from damages, the tenderer, could, secondly, seek to “set aside” the decision, with the effect that the choice of the procedure is devoid of legal effect and cannot be acted upon.⁴⁰ The third option provided by the remedies Directives is to seek interim relief.⁴¹ Without going into details, in awarding interim relief the court has to weigh *inter alia* in a “balance of convenience” the damages resulting from a delay to the procurement against the interests which may be prejudiced if no interim relief is given. Granting interim relief for the use of the wrong procedure would considerably delay the procurement and thereby cause a substantial inconvenience to the authority. As courts will be, consequently, rather reluctant to grant interim relief, this remedy is unlikely to be effective against the decision of the contracting authority to employ the negotiated procedure.

It is uncertain whether it is permissible under the restricted procedure to conduct negotiations with bidders during the award procedure. If an authority adopts a broad interpretation of the rules, as advocated above,⁴² and discusses certain aspects of the contract with the suppliers, the likelihood of making errors and breaching the procurement rules can be considered substantial. Accordingly, bidders are more likely to have effective remedies at hand when the authority tries to fit the PFI procurement process into the restricted procedure than in the case where the negotiated procedure is employed. Preferring the restricted to the negotiated procedure is additionally more costly, because it will be more difficult to find a solution presenting value for money.

It must not be lost out of sight that the European Commission is empowered by

³⁹ Fox/Tott, note 5 of ch.2, at para 3.3.10.

⁴⁰ For a more detailed account see: Arrowsmith, op.cit., note 2 of ch.1, p.904-905.

⁴¹ *Ibid.*, p.888-891.

⁴² See section 5.1.

means of Article 226 E.C. Treaty to institute proceedings before the Court of Justice when it suspects that a Member States failed to fulfil its obligation under the Treaty. The Commission has used this power in the last decade with notable vigour in the area of public procurement and appreciates that “the threat of legal action has led to more conscientious adherence to the legislation.”⁴³

The Commission often commences Article 226 proceedings after an individual or a company launched a complaint. Complaining to the “Guardian of the Treaty” offers substantial benefits to a tenderer as it remains anonymous and does not have to bear the risks and costs involved to seek remedies before national courts.⁴⁴ The overwhelming number of these complaints is settled in negotiations before they move to the judicial phase before the Court.

The European Commission recently used its powers under Article 226 to launch proceedings against the United Kingdom for using the competitive negotiated procedure in the course of a PFI scheme without meeting the respective derogations. In this respect, the risk of being challenged for not complying with the rules has already materialised and the outcome of these proceedings in the “Pimlico case” remains to be seen.⁴⁵

8.2.3. Findings

It is submitted that authorities procuring PFI projects need to have the opportunity to negotiate with prospective bidders. Even the Commission admits that concession-type contracts can only be awarded “when the awarding authority negotiates with several candidates.”⁴⁶ It follows from the analysis that this practical need is hardly compatible with the existing legal framework, which can be characterised as too prescriptive, too inflexible and far too adhered to outdated

⁴³ *European Commission, op.cit., note 15 of ch.3, p.47.*

⁴⁴ See for a more detailed account on the role of the individual within the Article 226 procedure: Harding, “Models of Enforcement: Direct and Delegated Enforcement and the Emergence of a “Joint action” model,” in: Harding/ Swart, op.cit., note 99 of ch.3, ch.2.

⁴⁵ “Pimlico” case, European Commission, (2000) *Single Market News* No.23 (October).

⁴⁶ European Commission, op.cit., note 24 of ch.3, p.11.

procurement methods.⁴⁷

The lack of compatibility is reflected in the great uncertainty over the circumstances in which the derogations for using the negotiated procedure apply and how strictly they have to be interpreted.

The Commission has recently recognised this deficit. It has proposed to introduce a new flexibility allowing a technical dialogue between the contracting authority and the candidates in the case of “particularly complex” projects. Initially, the Commission had specified in earlier documents that it was planning to introduce a “competitive dialogue” which would have operated alongside open and restricted procedure and would have replaced the existing “competitive” negotiated procedure with prior publication of a notice. This new procedure would have enabled contracting authorities to use a competitive form of the negotiated procedure as standard procedure without satisfying any narrowly defined requirements.

The proposal, however, was not implemented in the final draft of the Directive. The latter only extended the existing negotiated procedure with prior publication to “particularly complex” procurements. This implies that the burden rests on the contracting authorities to prove that the requirement of “particular complexity” is objectively satisfied. When drafting the criterion, the Commission had especially IT projects in mind, where buyers might be aware of their needs but do not initially know the best technical solution to meet them. Other instances intended to be included are new procurement arrangements where no precedents for the specific project are existing, such as the pathfinder projects in the early days of PFI.

The Commission’s proposals to amend the procurement rules have attracted criticism.⁴⁸ It appears unnecessary to deal with the proposals because they have not yet impacted on the PFI procurement practice. Furthermore, it appears doubtful

⁴⁷ Cf. for a detailed account: Arrowsmith, op.cit., note 2 of ch.1.

⁴⁸ Braun, “E.U. public procurement directives” (2000) *PFI Intelligence Bulletin* (Sept.), p.12; Arrowsmith, “The European Commission’s Proposals for new Directives on Public and Utilities Procurement” (2000) *P.P.L.R.* NA125.

*whether they will be implemented in their current form.*⁴⁹

8.3. Empirical findings

The question of whether it is permissible to apply the competitive negotiated procedure is probably the most important problem in PFI procurement from the insider perspective. This question also reflects the discrepancy between regulated public procurement and the commercial requirements of the real world. Hence, it was not surprising that this typical concern of PFI practitioners was prominently featured in the interviews with the legal advisors of the public sector.

The respondents fell into two camps on the issue of whether to use the negotiated procedure in PFI. One group followed the Treasury Taskforce (TTF) guidance and did not question the practice too much. They justified this approach by reference to the commercial requirements of PFI procurement and the innovative approaches delivered, which *per se* did not allow “overall pricing” or rendered it impossible “to draw up specifications with sufficient precision.” According to them, PFI fitted neatly into the Directives’ derogations. Lawyers in this camp did not discuss the issues involved in great detail on a project and considered the risks involved in adopting this approach as low.⁵⁰

A second group of lawyers advocated a more cautious approach to this issue. Those lawyers were generally more concerned about using the negotiated procedure than H.M. Treasury, because “they don’t have to take the risks.” They constantly considered the risks involved.⁵¹ For example, in the view of PubSA#3, the negotiated procedure should be put to the clients as the exceptional procedure and should only be a fallback position.

⁴⁹ Commissioner Bolkestein warned on November 30, 2000 that “Member States should not use this current exercise of simplifying and modernising the rules as a pretext to water down the crucially important principles of transparency and equal treatment of bidders. If the Commission considered the amendments under discussion went too far in this respect, I would regretfully have to abandon the proposals concerning complex contracts.” (2000) *Single Market News* 24, December 2000.

⁵⁰ BothSA#1; PubSA#1 .

⁵¹ PubSA#3; PubSA#10; PubSA#9.

Both camps differed only by a matter of degree in their assessment of the risks involved. Even lawyers of the first category said they outlined to their clients the controversy surrounding this issue⁵² and understood that they “made the projects fit”⁵³ into one of the derogations. For example, BothSA#2 raised the problem to his clients in such a way that his clients were justified to employ the negotiated procedure. Both camps of legal advisors also shared the perception of the reasoned opinion issued by the Commission against the U.K. in the Pimlico case on the ground that the negotiated procedure was unjustifiably employed in the PFI context. They perceived the case as a “bombshell”⁵⁴ aimed against the PFI procurement practice.

8.3.1. Negotiated procedure is perceived as most appropriate

All lawyers agreed that negotiations were a fundamental requirement of PFI procurement. Despite the legal difficulties inherent to the practice, only the negotiated procedure was perceived flexible enough to accommodate PFI projects appropriately. All lawyers were also aware of the potential legal difficulties involved.⁵⁵ BothSA#2 said that he sought to “make the negotiated procedure applicable.”⁵⁶ Others agreed that it was not “always easy”⁵⁷ to “put an argument together knowing that the Commission never meant it that way”⁵⁸ in order to fit PFIs in the narrow exceptions.⁵⁹ BothSA#3 said “we try to put a square peg through a round whole and have done the best we could. It might not be perfect and we are still trying to make it work ourselves.”

Despite the difficulties involved in making the PFI fit into the narrow exceptions, only two lawyers had experience in using the restricted procedure. One of them had to change award procedures halfway through the procurement process and switched to the negotiated procedure, because the restricted route did not allow sufficient room for

⁵² PubSA#10.

⁵³ PubSA#4; PrivSA#6.

⁵⁴ Editorial, (2000) *PFI Report* (October), p.1.

⁵⁵ “We assume that the negotiated procedure is applicable, but nevertheless we certainly understand what is going on” (BothSA#3).

⁵⁶ BothSA#2.

⁵⁷ PrivSA#6.

⁵⁸ BothSA#3.

⁵⁹ BothSA#2.

discussions with bidders.⁶⁰

The other example of using the restricted procedure was an equipment PFI for hospital scanners, a contract comparatively low in value. The buyer and providers had been accustomed to finance-leasing for many years and consequently the payment mechanisms did not require detailed discussions.⁶¹ These two cases appear to be rare exceptions. All but one lawyer advised to use the negotiated procedure and typical observations were that “there is no exception to this universal rule”⁶² and that “negotiations are vital to PFIs.”⁶³

8.3.2. Role of the TTF notes/ PFI procurement practice

One of the main reasons for the universal use of the negotiated procedure in PFI were the TTF guidance notes issued by the H.M. Treasury. PubSA#2 and PubSA#3 observed that the TTF guidance advocated the use of the negotiated procedure “always”⁶⁴ and “automatically”⁶⁵ in PFI. More than half of the respondents used the Treasury guidance notes as reference in interpreting the procurement rules.⁶⁶ They took comfort in the unambiguous recommendation and advised accordingly.⁶⁷ Lawyers were aware that the “political steer”⁶⁸ and the “strong political pressure”⁶⁹ did not provide authorities with a valid legal argument.⁷⁰

Notwithstanding this awareness, they were reluctant to give contradictory advice because this practice was perceived as government policy. The application of the negotiated route thereby became a firm cornerstone of the PFI procurement practice. PubSA#4 thought that it would be “quite odd if you would not use it.” PrivSA#3

⁶⁰ BothSA#3.

⁶¹ PubSA#3.

⁶² BothSA#1; PubSA#2; PrivSA#3; PubSA#4; PrivSA#6; PubSA#6; BothSA#3; PubSA#4; PubSA#9; PubSA#10; PrivSA#6.

⁶³ PrivSA#6.

⁶⁴ PubSA#2.

⁶⁵ PubSA#3.

⁶⁶ PubSA#1.

⁶⁷ PubSA#10; BothSA#4.

⁶⁸ Mentioned by many interviewees, inter alia PubSA#9.

⁶⁹ PubSA#8.

⁷⁰ At least twice.

further remarked that the PFI market had proceeded on the basis that the negotiated procedure was applicable. He said the procurement process was complicated and did not easily fit into any other procedure.⁷¹ It is interesting that the combination of TTF guidance and lawyers' experience in using this procurement procedure has apparently resulted in a legal practice.⁷² Practitioners do not question the practice and find it difficult to deviate.⁷³ PubSA#10 suspected that

“a lot of people have taken a “safety in numbers” approach, because everybody is doing it, why shouldn’t we?”

PubSA#4 added that

“lawyers are told that PFI comes within it and what they do is they convince themselves that the words fits the facts.”⁷⁴

Those legal advisors who took a more cautious approach towards the rules criticised the TTF guidance as not helpful and rather misleading. PubSA#3 said this included that the guidelines did not sufficiently emphasise the exceptionality of the negotiated procedure. BothSA#5 reported that his U.K. clients were convinced that the negotiated procedure applied before they looked at their individual project. BothSA#5 observed that the U.K. situation was very different from that in Ireland. He said Irish authorities diligently examined on a case-by-case basis whether the negotiated procedure was applicable or not. In contrast, the U.K. authorities were persuaded by the TTF guidelines and perceived them as binding. BothSA#5 mentioned that authorities had ceased to consult their legal advisors on the use of the negotiated procedure. This was said to be part of a tendency to bring external legal advice on board later in the process. Lawyers were consulted once the project has already been advertised and difficult legal situations arose, such as changes to the specifications.⁷⁵

⁷¹ PrivSA#3.

⁷² PubSA#10.

⁷³ BothSA#1.

⁷⁴ PubSA#4.

⁷⁵ BothSA#5; contradictory evidence: “Generally, the public sector is very loathed to use the negotiated procedure, they feel very, very uncomfortable about it. People have to be

In their daily practice, the overwhelming number of lawyers endorsed the solutions suggested in the Treasury guidelines. More cautious lawyers said that they had “a slightly uncomfortable feeling”⁷⁶ about the practice advocated in the TTF guidance, but used the negotiated route nevertheless.

Yet, this guidance arguably contravenes the wording of the Directives and the interpretation favoured by the European Commission.⁷⁷ Alluding to the reasoned opinion issued by the Commission in the Pimlico case against the U.K., BothSA#1 and BothSA#2 suggested that the Commission pursued a hypocritical stance on this issue. On the one hand it supported infrastructure projects, such as Trans European Networks (TENs), whilst on the other hand it did not want authorities to adopt a necessary “commercial approach”⁷⁸ when delivering those projects.

The role of the Treasury in establishing this legal practice and the socio-economic elements maintaining a coherent approach will be discussed in chapter 12.

8.3.3. Commercial requirements

Apart from the recommendation of the Treasury, BothSA#1 said the decision to apply the negotiated procedure was influenced by the commercial necessities of the project. Contracting authorities sought refuge in the negotiated procedure which allowed the adoption of a commercially oriented and flexible approach to procurement. All but two lawyers⁷⁹ agreed that it was almost impossible to procure PFIs under the less flexible restricted procedure.

8.3.3.1. Proposed solutions differ

Interviewees said that in a usual PFI scheme the commercial approaches offered by bidders differed substantially. PubSA#10 gave the example of a PFI school project, which appeared straightforward on first glance in the light of the existing level of

encouraged to use the negotiated procedure, since I think that they are running into the danger of breaching the restricted procedure.” (PubSA#3).

⁷⁶ PrivSA#3.

⁷⁷ BothSA#2; BothSA#5.

⁷⁸ BothSA#1

⁷⁹ PubSA#3 and PubSA#9 gave examples of small PFIs where it is possible to deliver by using the restricted route.

standardisation. Bidders came up with very different solutions depending on whether they planned to refurbish the existing asset or proposed to build a new school building on land owned by the consortium.⁸⁰ The contracting authority had to gain a clear understanding of the different solutions, because of the long contract term and the pertinence of the areas contracted out, such as schools and hospitals.⁸¹ PrivSA#6 mentioned the differences between the proposed solutions made the projects complicated and volatile.

Furthermore, the public sector was habitually uncertain about the final result it wanted to achieve.⁸² PrivSA#6 observed that the differences in approach were inherent to PFI, as it was a major aim of the public sector to draw innovation from the private sector.

8.3.3.2. Projects differ

BothSA#2 remarked that PFI projects still differed substantially from each other even if the projects belonged to the same sector. Although PFI hospitals might have some contractual and financial features in common, respondents said project specific issues had to be dealt with in negotiations.⁸³

PubSA#10 mentioned that the payment mechanism was a project specific issue which differed substantially from project to project. PubSA#3 remarked that another difference between otherwise similar projects was the allocation of risks amongst the parties to the contract. PubSA#3 added the parties had to work out the precise objective of the contract before they could plot the numbers into the financial model. “That is because you try to have this innovation and flexibility.”⁸⁴

8.3.3.3. Negotiations ensure competition

Another commercial reason to choose the negotiated procedure was, as PrivSA#6 maintained, that it provided the authority with the opportunity to ensure full

⁸⁰ PubSAs#10.

⁸¹ PrivSA#3.

⁸² PrivSA#6.

⁸³ Almost every respondents.

⁸⁴ PubSA#3.

competition between bidders. He said it was in the public sector interest to negotiate because that was the way to get the best price.⁸⁵ PrivSA#6 said “there is a very competitive market between contractors and there is a very competitive market between the funders which provide 90% of the venture capital.”

He suggested it was effectively impossible to capture the degree of competition necessary in the first bid in an open or restricted procedure. “As the list of the bidders gets smaller the funders and the sub-contractors bidding to them give them better prices in the hope of winning,” he said and added that “this is a dynamic process that depends on fluidity and in procurement terms on negotiations.”⁸⁶

8.3.3.4. Fluid specifications require negotiations

PubSA#10 said negotiations were further indispensable due to uncertainties surrounding the level of services to be provided and their demand. She added, those uncertainties were inherent to PFI. In order to reap innovative solutions, authorities drew up output-based specifications which specified the project only in very broad terms. PFI projects authorities were always uncertain at the outset about what exactly to procure in size, scope or value. The uncertainty resulted, according to PrivSA#6, in “fluid specifications” which were successively refined in negotiations throughout the procurement process. PubSA#10 added that PFI procuring authorities should in theory not be over-prescriptive about what they were procuring. This notion collided in practice with the interests of the procuring authority to influence the design of the project.

8.3.3.5. Practical requirement to negotiate

PubSA#9 indicated that the advantages of using the negotiated procedure were obvious and its choice was *inter alia* a matter of convenience. BothSA#2 also assumed that it was more convenient for all parties to use the negotiated procedure and to avoid the difficulties of running a bid process for this kind of project under the open or the

⁸⁵ PrivSA#6.

⁸⁶ PrivSA#6.

restricted procedure. BothSA#3 argued that the restricted procedure posed a number of other questions, such as whether it was permissible to conduct pre-tender negotiations. He added that it was inconvenient for all parties firstly to negotiate the contract and then to bid against definite and unchangeable specifications.⁸⁷ BothSA#3 thought the alternative to using the negotiated procedure would be quite difficult to implement in the light of varying bids. BothSA#2 agreed in observing that “what you want in a PFI contract is to negotiate properly. You want to negotiate with someone and go through a process of refining the terms. Putting out a tender doesn’t really get you there.”

BothSA#2 found it questionable whether it was possible to achieve the same depth of negotiations by sending out contract documents after one or more rounds of negotiations against which bidders submit a firm price.⁸⁸ BothSA#2 thought the problem with this approach was that it did not allow the banks to have their say, because they were not involved at that stage. If people would move away from the current structure of negotiations, the banks had to be involved earlier, resulting in an increase of the already high bidding costs.⁸⁹

The European Commission probably favours this kind of restricted procedure with pre-tender negotiations.⁹⁰ PubSA#4 felt it has the disadvantage that authorities might end up with extensive post-tender or post-award negotiations conducted in a non-competitive manner. PubSA#4 expressed her concern that the use of the restricted route might provoke more procedural mistakes than the negotiated process.

⁸⁷ This is probably the way the Commission would like to see PPPs delivered under the procurement regime.

⁸⁸ BothSA#2.

⁸⁹ BothSA#2.

⁹⁰ The Commission contemplates in its recent proposal to procure particular “complex projects” in a procedure resembling a conventional restricted procedure with pre-tender negotiations with no further negotiations during the award phase, European Commission, *op.cit.*, note 19.

8.3.4. Which derogation was employed?

Whilst some legal advisors, such as PubSA#4, employed both derogations in combination, the majority of projects have been procured under the “overall pricing” ground as recommended by the Treasury guidance.⁹¹

8.3.4.1. Overall pricing is impossible

Based on the Treasury’s approach to interpret the “overall pricing” derogation,⁹² BothSA#3 criticised the widespread use of the overall pricing in PFI as “complete nonsense.” He explained that authorities normally prepared a very sophisticated spreadsheet before they launched the PFI scheme. The spreadsheet provided them with the debt/equity split and the project risks allowing them to price the contract.⁹³ Other advisors also agreed that overall pricing was possible, although this “might be a question of degree.”⁹⁴ PubSA#4 observed that if the authority was looking for a global figure, it should be able to get one.

The situation where it was impossible to price the contract were rather the exception. PubSA#2 gave the example of the refurbishment of a community hospital where not much high-tech equipment and no new buildings were involved. She said the NHS Trust could have a “good guess” of the pricing in advance and a good idea of what the specifications would look like. Her interpretation of the “overall pricing” derogation combined the second and third interpretative approach outlined in section 8.2.1.1. She apparently thought the derogation became applicable, if it would not be possible for the authority to predict what solutions bidders would propose or the amounts they would be bid. PubSA#2 concluded that in considering the existence of standard contracts, it might become more difficult to justify the application of the negotiated procedure on the ground of the overall pricing derogation.

⁹¹ BothSA#3.

⁹² See above section 8.2.1.1.

⁹³ BothSA#3.

⁹⁴ PubSA#4.

PubSA#7 said she had fundamental difficulties to understand how price can be a fundamental criterion in a contract not permitting overall pricing. The authority had to find a basis to evaluate what different options would cost. If not, the whole procurement would be questionable.

Sharing the Treasury's interpretation of the overall pricing derogation, PubSA#4 said:

*"We all know when we see a bidder's option what it is going to cost and you will look what the option does to your forecast. Pricing is predictable and if it weren't no bank would back it."*⁹⁵

She added that even a cost plus situation permitted overall pricing because it was feasible to work out how long it would approximately take to erect the asset, what it would cost per day and to multiply the one by the other. "I find it very difficult to think of a contract that does not permit overall pricing. Nobody will enter into such a contract without estimating what the costs will be."⁹⁶

The scepticism was partly sparked by the experience with PFIs in the U.K. and the recent development of standardised contract terms. Both developments should not disguise that historically the reasons for using the negotiated procedure in PFI were that it was impossible and "impractical"⁹⁷ to accurately price the project. PubSA#2 thought that this ground sat quite neatly with the procurement rules, especially where variant bids were permitted.⁹⁸ She added it was impossible for the authority to price the project until bidders came forward with their proposals.

PubSA#4 mentioned that clients did only know how much they could afford. Her public sector clients said at the outset it was impossible to price and it had to be seen what kind of innovative solutions the tenderers proposed. PubSA#4 said that

⁹⁵ PubSA#4.

⁹⁶ PubSA#4.

⁹⁷ PubSA#4.

⁹⁸ PubSA#10.

negotiations were necessary even after the bids were submitted. PubSA#9 said the decisive question was whether the authority could draw up specifications against which tenderers could bid and pass. She added that this was impossible in the overwhelming number of PFIs.⁹⁹

The wording of the Directive suggests that the overall pricing derogation may only be used in exceptional circumstances. The majority of lawyers agreed that this exceptionality requirement was in practice “largely ignored.”¹⁰⁰ This was again at least partly due to government advice and the procurement practice as it developed over the years.¹⁰¹

PubSA#3 adopted the Treasury’s interpretation of “exceptionality” and argued PFI contracts might be of an exceptional nature for the procuring authority because they remained exceptionally in comparison to the many other contractual arrangements they entered into.¹⁰² PubSA#3 gave the example of a NHS Trust which probably entered into 600 or 700 contracts a year, only one of which was probably a PFI project. Hence, PFIs were not only exceptionally complex in nature but also an exceptionally rare occurrence in the authority’s procurement practice.

Others remarked that this line of argument was questionable because the derogation was used in almost every project. The use of the negotiated procedure on this ground was no longer exceptional in any respect, but common procurement practice.¹⁰³

8.3.4.2. Specifications cannot be drawn up with sufficient precision

The second derogation frequently used in PFI procurement allows using the negotiated procedure where “specifications cannot be drawn up with sufficient precision.” Authorities employed this derogation because it was not possible to come up with detailed technical specifications at the end of the shortlisting stage. PubSA#6

⁹⁹ PubSA#9.

¹⁰⁰ BothSA#1; PubSA#2; PubSA#4.

¹⁰¹ PubSA#4.

¹⁰² PubSA#3; PubSA#9.

¹⁰³ PubSA#7.

indicated the need for a considerable amount of discussions with bidder to find out what the customer wanted and what the bidder could supply. Another argument brought forward in favour of using the derogation was that the use of output-based specifications made it rarely possible to draw up “sufficiently precise” specifications.¹⁰⁴ PubSA#8 highlighted the wide range of solutions made it very difficult for the authority to draw up specifications which were so rigid to make the application of the restricted procedure feasible.

8.3.5. Impact of standardisation

Lawyers held the standardisation process did not have a major impact on the issue of whether to use the negotiated procedure. Nevertheless, nuances became apparent in the replies to the question.

More than half of the interviewees insisted that only the contractual terms were standardised and not the more important and more complex financial terms.¹⁰⁵ The payment mechanism still required extensive negotiations due to the many options available.¹⁰⁶ PubSA#3 had experience in an area of PFI where also the payment mechanism became subject to standardisation.¹⁰⁷ It is for this reason that PubSA#3 and PrivSA#6 predicted it would become increasingly difficult to justify the application of the negotiated procedure. PubSA#9 perceived this scenario as not desirable.¹⁰⁸

8.3.6. Balancing the risk of being challenged

Lawyers unanimously held that bidders would not launch challenges on the ground that the negotiated procedure was employed.¹⁰⁹ The risk of challenges was therefore negligible. PubSA#4 mentioned that she outlined to her clients that the law was uncertain on whether it was legitimate to use the negotiated procedure and the practice was largely based on Treasury Taskforce guidance. Apart from this standard

¹⁰⁴ BothSA#3.

¹⁰⁵ For example: PubSA#7; PubSA#8; PubSA#3; PrivSA#6; PrivSA#1; BothSA#1; PubSA#1; PubSA#2.

¹⁰⁶ PubSA#8.

¹⁰⁷ PubSA#3.

¹⁰⁸ PubSA#9.

¹⁰⁹ PubSA#2.

“health warning,” PubSA#1 recommended her clients to “just go ahead with their project.” She underlined that nobody from the bidder community questioned this issue. BothSA#6 remarked that using the restricted route as alternative would make the project even more unworkable and cumbersome. This could have the consequence that authorities made more procedural mistakes and thereby increased the risk of being challenged on a procedural irregularity.

The recent Harmon case did not influence this risk assessment, although all but two lawyers knew of the case.¹¹⁰ PubSA#4, PrivSA#2 and BothSA#4 said the attitude towards challenging authorities remained unchanged. This was especially true for the application of the negotiated procedure. Conversely, private sector bidders were pleased with this practice as it allowed them to present their bids in more detail.¹¹¹

8.4. Analysis

From an outsider perspective, procurement law seems to have only negligible impact on the PFI procurement practice with respect to the choice of procedure. Practitioners opted for the negotiated procedure without spending much thought about whether this practice was justified or not.

The impact of procurement law on the PFI procurement practice was compromised by the general lack of enforcement through bidders in national courts. To the dismay of public and private sector advisors, the Commission commenced enforcement action in support of its strict interpretation of the law. The “Pimlico case” challenged the application of the negotiated procedure in a PFI school project and thereby a procedural cornerstone of the scheme. In Article 226 E.C. Treaty proceedings the defendant is the Member State and not the awarding authority. Therefore, it is questionable whether an ECJ ruling could have a direct impact on the individual project.

¹¹⁰ PrivSA#1; PubSA#2.

¹¹¹ PrivSA#6; PubSA#4.

Chapter 9 Selection of bidders and contract award criteria

9.1. Introduction

The aim of European public procurement law is to combat discriminatory behaviour whilst at the same time allowing regulated authorities to let contracts to suppliers under the most favourable conditions.

The Directives include three principal techniques to achieve this aim. These instruments are (1) Community-wide advertising of contracts, (2) prohibition of specifications capable of discriminating against potential bidders, and (3) application of objective and commercial criteria for participation in tendering and award procedures.

The latter principle has been viewed as an invaluable tool against using public procurement to promote a variety of industrial, social, environmental¹ or general political concerns.² Those “secondary” concerns were abused in the past to disguise “buy national” policies. It is for this reason that the European Directives, their underlying principles and the E.C. Treaty significantly restrict the employment of “secondary” criteria to select bidders or awarding contracts.

The following chapter considers the qualification, selection and award criteria permissible under the procurement rules. It first defines the three distinct stages of qualification, shortlisting and contract award and then outlines the criteria to be employed at each stage. Finally, the empirical findings with respect to the qualification and selection of bidders will be outlined and interpreted.

9.2. Selection of bidders and contract award criteria – the legal problems

Before considering the criteria used to select and shortlist contractors and, finally,

¹ Westphal, “Greening procurement: an attempt to reduce uncertainty” (1999) *P.P.L.R.*, 1; cf. the power of local governments in the U.K. to promote or “improve economic, social and environmental well-being” (ESEWeb), DETR, *Power to promote or improve economic, social and environmental well-being*, March 2001.

² Arrowsmith, “The Legality of “Secondary” Procurement Policies under the Treaty of Rome and the Works Directive” (1992) *P.P.L.R.* 412; Arrowsmith, *op.cit.*, note 9 of ch.1; Fernández Martín/ Stehmann, *op.cit.*, note 38 of ch.3; Geroski, “*Procurement Policy as a tool of industrial policy*” (1990) *International Review of Applied Economics*, p.182.

to award contracts it is worthwhile to recall briefly the three distinct stages involved in this process.

The European Court of Justice has stressed in the *Beentjes* case that the “examination of the suitability of contractors to carry out the contracts... and the awarding of the contract are two different operations... covered by different rules.”³ The Court added that qualification and award procedures may be conducted simultaneously. Contracting authorities should differentiate between the distinct sets of criteria. For instance, when examining the merits of the proposals, authorities should not be influenced by the tenderer’s financial capacity. Conversely, authorities should not give a tenderer which has failed to satisfy the pre-established selection criteria a second chance, because its proposal appears advantageous.⁴

9.2.1. Selection of bidders

9.2.1.1. Qualification criteria

Contracting authorities may examine the *suitability of suppliers* only on the basis of the qualitative criteria established in the Directives.⁵ The rules on participation contained in each public sector Directive can be subdivided into three categories, namely financial standing, technical capacity and legal or “miscellaneous” criteria. The first ground of exclusion allows the authority to seek evidence relating to the financial standing of the candidate.⁶ This evidence forms the basis for the application of certain expressly regulated financial criteria.⁷ Firms are permitted to produce other evidence where they have a valid reason not to produce the specific information

³ Case 31/87 *Gebroeders Beentjes v. The Netherlands* [1988] E.C.R. 4653, paras 15, 16 of the judgment.

⁴ European Commission, *Guide to the Community Rules on Public Works Contracts*, para 6.1.

⁵ Case 76/81 *SA Transporoute v. Minister of Public Works* [1982] E.C.R. 417.

⁶ The evidence permissible to be taken into account is not limited to the criteria listed in the Directives: Joined Cases 27 to 29/86 *SA Constructions et entreprises industrielles (CEI) v. Societe cooperative ‘Association intercommunale pour les autoroutes des Ardennes’ and Others*, [1987] E.C.R. 3347, paras 11-18 of the judgment.

⁷ Directive/ Reg. 15(I) of each set of Regulations.

demanded⁸ and the authority deems such alternative information to be adequate.

Tenderers may also be excluded from tendering if they lack the technical capability to perform the contract. This decision is based on considerations such as the skills, tools, manpower and general experience of the prospective provider, as far as they are related to the specific project.⁹ In contrast to the evidence for the financial standing of firms, the evidence permissible to prove technical capability is exhaustively laid down in the Directives.¹⁰ Article 32(1) of the Services Directive contains the only exemption from this general rule. The provision vests authorities with a general discretion to assess the “ability” of service providers with regard to their “skills, efficiency, experience and reliability.”¹¹ It is submitted that authorities have to accept any “reasonable” evidence offered by providers as an alternative to the evidence demanded.¹²

Finally, the Directives contain other grounds for the exclusion of providers which are mainly related to their ability to complete the contract, such as an order for compulsory winding up of the business. Other criteria are not directly related to the performance of the contract, such as conviction of a criminal offence.¹³

In response to unions’ criticism of the PFI scheme,¹⁴ the Treasury Taskforce issued a policy statement on the “disclosure of information and consultation with staff

⁸ Works Reg. 15; Supply Reg. 15(4), Services Reg. 15(4).

⁹ Cf. *R v. Secretary of State ex. p. London Borough of Harrow* (The Times, January 16, 1996).

¹⁰ This is expressly regulated in the U.K. Regulations, and is, on European level, part of the case law developed by the ECJ in: Case 76/81 *SA Transporoute et travaux v Ministere des travaux publics* [1982] E.C.R. 417; Cases 27 to 29/86 *SA Constructions et entreprises industrielles (CEI) v. Societe cooperative ‘Association intercommunale pour les autoroutes des Ardennes’* [1987] E.C.R. 3347; Case 71/92 *Commission v. Spain* [1993] E.C.R. I-5923.

¹¹ It is noteworthy that this restriction is not included in the U.K. Services Regulation 16(1), which is implementing Article 32(1) of the Services Directive.

¹² Arrowsmith, op.cit., note 2 of ch.1, p.318.

¹³ For a full account of the grounds see Arrowsmith, op.cit., note 2 of ch.1, pp.331-341; Piselli, “The Scope for Excluding Providers who have Committed Criminal Offences under the E.U. Procurement Directives” (2000) *P.P.L.R.* p.267.

¹⁴ For example: UNISON, *Downsizing for the 21st Century A report to UNISON Northern Region on the North Durham Acute Hospitals PFI scheme* (1999); UNISON, *Step by Step – UNISON Guide to the PFI Process* (1998).

and other interested parties.”¹⁵ This statement is concerned with involving staff representatives throughout the PFI procurement process by consulting them on employment issues. Between the advertisement of the contract and the completion of the pre-qualification stage, staff representatives should be invited to provide the department with “relevant” employment related information on tenderers. From a procurement law perspective, this recommendation raises the question of whether it is permissible to consider such information at pre-qualification stage.¹⁶

The question appears to consist of two interrelated elements. The first issue is whether it is permissible at all to consider information not directly obtained from the bidder. Secondly, it is questionable whether employment issues, such as the employment track record of the provider, has to be taken into account at either the qualification, shortlisting or award stage.

It can first be noted that the information has to be related to the criteria permitted under the Directives. The protection of bidders against arbitrary criteria is a major legislative rationale underlying the criteria.¹⁷ It seems therefore irreconcilable with the Directives to investigate into areas which are not part of the technical, financial or legal requirements¹⁸ or go beyond the limits stated in the Directives. It is arguable¹⁹ with respect to information relating to one of the defined three categories that additional information obtained from other sources than the bidders does not jeopardise bidders’ protection against arbitrary selection criteria. On that basis it seems permissible to consider information which was either in the possession of the

¹⁵ H.M. Treasury, op.cit., note 14 of ch.2 (Disclosure of information).

¹⁶ It has been suggested by Arrowsmith that although this option is not spelled out in the procurement Directives, contracting authorities are only free to use information which could not be demanded under the Directives to prove that providers are qualified, Arrowsmith, op.cit., note 2 of ch.1, p. 327.

¹⁷ Arrowsmith, op.cit., note 2 of ch.1, p. 328.

¹⁸ Case 31/87 *Gebroeders Beentjes v. The Netherlands*, [1988] E.C.R. 4653, para 17 of the judgment.

¹⁹ In particular when one adopts a literal approach, cf. Article 22 Works Directive 93/37: selection of tenderer shall be based “on the basis of the information given.”

contracting authority or which was provided by third parties.²⁰

The principle of transparency may require that the tenderer should be briefed on the information obtained. The authority should further give the bidder the opportunity to comment.²¹ Some limited support for this stance can be derived from a judgment of the Court of First Instance which deduced from the principle of transparency that “a company which is closely involved in a tendering procedure... must receive, without any delay, precise information concerning the conduct of the entire procedure.”²²

The question arises whether the results of the consultation rounds with trade unions and staff representatives and the outcomes of their discussions with prospective providers may be considered at pre-qualification or shortlisting stage. As we have seen, the qualification criteria to expel firms from the tendering process must be strictly related to the criteria conclusively laid down in the Directives. Thus, contracting authorities are clearly not permitted to take general employment issues into account when conducting their qualification process.

There are two exemptions from this rule expressly regulated in the Directives. Providers may be excluded from participation in the contract if they failed to pay social security contributions or were convicted of a crime.²³ It has been further suggested in *General Building and Maintenance Ltd. v. Greenwich Borough Council*²⁴ that “technical capability should be defined in a broad manner” so as to include the provider’s “ability competently to carry out the necessary operation of the contractor’s trade... with proper regard to the health and safety of the public and of employees.”²⁵ This broad interpretation of “technical capability” includes the provider’s health and safety record in so far as it relates to its technical capability of performing tasks under

²⁰ This view is shared by Sir Godfray Le Quesne in *General Building and Maintenance Ltd. v. Greenwich Borough Council* [1993] I.R.L.R. 535, para 42 of the judgment.

²¹ Similar situation: Case T-203/96 *Embassy Limousines & Services vs. European Parliament*, judgment of 17 December 1998 (unreported).

²² *Ibid.*, para 85 of the judgment.

²³ Article 24(c) Directive 93/37; 20 Directive 93/36; 29(c) Directive 92/50.

²⁴ [1993] I.R.L.R. 535.

²⁵ [1993] I.R.L.R. 535, p. 543, para 40.

the contract.²⁶ It appears questionable whether the findings of the *Greenwich* case are consistent with the Court of Justice's ruling in *Beentjes*. In *Beentjes*, the ECJ held that a condition not required by law did not relate to technical capacity.²⁷

Arguably, this implies that it is only permissible to consider legal requirements, which in the United Kingdom includes Regulations 14-16. According to the ECJ, a wider interpretation of the technical capability criterion as suggested in *Greenwich* is ruled out.

9.2.1.2. Shortlisting criteria

In the open procedure, every tenderer is automatically entitled to participate in the award procedure. If the authority employs the restricted or negotiated procedure it may limit the number of suitable candidates invited to tender or negotiate.²⁸ "Shortlisting" refers to the selection process among qualified firms which aims at limiting the number of firms participating in the final stages of the procurement process.

In order to ensure genuine competition, the authority is obliged to shortlist at least three candidates if the competitive negotiated procedure is used and five if the authority employs the restricted procedure.²⁹ During the "shortlisting" exercise, the awarding authority whittles down the number of tenderers by selecting those candidates which are "relatively" best qualified³⁰ with respect to the qualification criteria.³¹ It is therefore not permissible to employ criteria at shortlisting stage which

²⁶ Arrowsmith, "Restricted Award Procedures under the Public Works Contract Regulations 1991" (1993) *P.P.L.R.* CS 99; However, it is not clear whether the contracting authorities can only consider health and safety obligations as imposed by law, or whether they may require more burdensome obligations.

²⁷ Para 28 of the judgment.

²⁸ Treumer, op.cit., note 86 of ch.3, p. 147; Arrowsmith, op.cit., note 2 of ch.1, p.217; Boyle, note 86 of ch.3.

²⁹ Case 27/98 *Metalmeccanica Fracasso v. Amt der Salzburger Landesregierung*, [1999] E.C.R. I-5697, para 28 of the judgment.

³⁰ It is not entirely clear, whether the shortlisting criteria relate to ordinary selection criteria or may also include an approximation to the award criteria, see: Treumer, op.cit., note 86 of ch.3, p.151 ff.

³¹ Where the criteria have not been stated in advance, the authority may not eliminate any candidates who have met the basic criteria from the procedure.

are incompatible with the qualification criteria laid down in the procurement Directives. For example, it is unacceptable to shortlist otherwise qualified bidders on the basis of employment related issues, as it is envisaged in U.K. government guidance.³²

It is questionable whether government departments were permitted to employ one of the three following shortlisting criterion PFI: the “development of PFI industries,” the “compulsory use of standardised contract terms” and the “ability to form a good working relationship.”

The first policy consideration, which contracting authorities considered in early PFI projects at shortlisting stage, is to foster the development of PFI industries in particular areas. Contracting authorities sought to promote the development of “road operating industries”³³ and a market in “PFI prisons.”³⁴

There were two principal objectives. Government departments wanted to ensure that for future projects they would be able to choose from a wider range of contractors.³⁵ To achieve this aim, departments awarded PFI contracts to several suppliers rather than awarding similar contracts to the same consortium of providers.³⁶ Secondly, authorities perceived the risks of awarding different contracts

³² The H.M. Treasury Taskforce policy statement avoids a precise determination of the decisive question of when the firms with the negative track record should be expelled from participating in the tendering procedure. The statement maintains at para 4.3.1 that “a bidder’s employment track record [...] should be one of the factors taken into account when evaluating and deciding bids.” By using the terms of “evaluating and deciding,” the Treasury effectively renders it impossible for the observer to find out at which stage of the procurement procedure this process should actually happen. However, it is quite clear from an economic viewpoint that contracting authorities are interested to exclude firms with a negative employment from the tendering process as soon as possible, meaning rather at the shortlisting stage than at the contract award stage.

³³ Highway Agency, op.cit., note 16 of ch.2, para 1.4.

³⁴ Public Accounts Committee, op.cit., note 70 of ch.2, at para 5.

³⁵ A similar policy was set out in H.M. Treasury, *Setting New Standards – A strategy for Government Procurement* (1995) at paras 3.13–3.15: “Departments will not act in ways in which damage competition” in “weighing the short term gains against the long term” benefit of being not dependent on one supplier and “to encourage suppliers to enter” even poorly developed markets.

³⁶ This was much debated during the first two prison projects, where one option would have been two award both prisons to one contractor and thus to realise a number of synergies resulting eventually in substantial savings of £30 mio. compared with the option of

to one provider as being very high. In particular, the risk of not delivering on time was considered substantial.³⁷

Government departments were further anxious to allocate the contracts with different consortia to enable as many private sector firms as possible to progress through the learning curve.³⁸ Bidders had to become acquainted with the complex bidding procedures and also with the new and innovatory construction methods employed.³⁹ Early PFI projects were further used as an instrument to familiarise as many private sector firms as possible with the operation of services which had never been delivered by a private sector firm before. A good example for such a traditional public sector service where the private sector lacked previous experience was the provision of custodial services.

Authorities developed PFI industries in various areas by refusing better offers at shortlisting stage for the reason that the tenderer had already delivered another PFI project.⁴⁰ Ejecting bidders for this reason could be viewed as a threshold for the delivery of large-scale infrastructure projects. Authorities could argue that the threshold was established for the sake of bidders which should not carry out more than one PFI project at a time to avoid stretching their financial and technical resources to the limits.

It can be argued with the Court of Justice in CEI/Bellini that if the practice is based on this notion, it is reconcilable with the Directives. “Member States remain free to maintain or adopt substantive and procedural rules in regard to public... contracts on condition they comply with all the relevant provisions of community

awarding the two contracts to different providers, House of Commons, Public Accounts Committee, op.cit., note 173 of ch.2, para 20.

³⁷ Ibid., Examination of the witnesses, para 33-39.

³⁸ In particular the CBI was concerned in the early days of PFI that the lack of a U.K. owner-operator industry could pose a significant competitive disadvantage for the U.K. industry, CBI, op.cit., note 98 of ch.2, pp.18-21.

³⁹ House of Commons, Public Accounts Committee, op.cit., note 173 of ch.2., examination of the witnesses, para 48.

⁴⁰ This also occurred in the first two Prison projects (cf. above note 36) and in the first four major road projects, NAO, op.cit., note 40 of ch.2, Evidence of the witnesses, para 40-45.

law.”⁴¹ *The practice was held not to contravene the non-discrimination principle, because it did not restrict access by contractors from other Member States.*

It is noteworthy that the imposition of thresholds for PFI contracts delivered by one contractor was only a minor consideration identified by authorities and H.M. Treasury. The major rationale behind this policy was the development of PFI industries. Yet, supporting new PFI industries is not related to the financial standing or technical capability of the contractor, or to other legal criteria laid down in the Directives. Hence, authorities are not legally permitted to employ the criterion of developing PFI industries when qualifying or shortlisting tenderers.

The second questionable shortlisting criteria employed in PFI is the compulsory acceptance of standardised contract terms. The establishment of standard or model contract conditions⁴² was one cornerstone of Sir Malcolm Bates’ first review of the Private Finance Initiative.⁴³ Bates claimed that “with standardisation of tender documents, legal fees and other costs will be sharply reduced, as will the time spent negotiating with a preferred bidder.”⁴⁴

Another reason put forward in favour of contract templates is the consistency of approach and of pricing across a range of similar services. standard contracts avoid “reinventing the wheel” for each issue likely to be common to all PFI projects⁴⁵ and promote common understanding as to what risks are included in a typical PFI project.⁴⁶ In July 1999, the Treasury Taskforce published a general guidance on the

⁴¹ Joined Cases 27 to 29/86 *SA Constructions et entreprises industrielles (CEI) v. Societe cooperative ‘Association intercommunale pour les autoroutes des Ardennes’ and Others*, [1987] E.C.R. 3347, paras 13-18 of the judgment.

⁴² *Ibid.*, para 10 of the judgment.

⁴³ H.M. Treasury, *op.cit.*, note 10 of ch.2.

⁴⁴ *Ibid.*

⁴⁵ Private Finance Panel, *op.cit.*, note 156 of ch.2, para 12.

⁴⁶ H.M. Treasury, *Taskforce Standardisation Document for final Consultation* (1999), para 1.1.3.

standardisation of PFI contracts⁴⁷ which will be followed up in due course by sector specific guidance in the areas of IT,⁴⁸ defence, health (NHS) and local authorities.⁴⁹

The procurement Directives predominantly regulate the tendering process up to the award of the contract. They do not contain explicit requirements for post-tender matters, such as contractual terms and conditions that contracting authorities have to consider when drafting contract templates. In the absence of explicit rules, only the principles underlying the directives are applicable.

Contract templates are therefore reconcilable with the European procurement regime, provided that they avoid direct or indirect discrimination against providers from other Member States.⁵⁰ Furthermore, the principle of proportionality⁵¹ requires that contracting authorities must refrain from imposing unreasonable contractual terms and conditions.⁵²

There is considerable evidence that at least in one case⁵³ a contracting authority evaluated bidders on their acceptance of standardised contract terms. The department allocated evaluation marks at the shortlisting stage expressly on the basis of conformity with contractual risk allocation templates contained in the preliminary

⁴⁷ H.M. Treasury, Treasury Taskforce, op.cit., note 17 of ch.2 (PFI contracts).

⁴⁸ H.M. Treasury, op.cit., note 17 of ch.2 (IT contracts).

⁴⁹ Unsurprisingly given the public sector provenance of the document, the consultation draft and the final standardisation document received a mixed response from private sector participants in the PFI market. It was suggested that many contractual issues are either not susceptible to uniform treatment or should rather be negotiated anew for every project in order not to constrain original and innovative thought and allow the market to develop further.

⁵⁰ This could be viewed in the light of the *Beentjes* decision as an infringement of Articles 6 and 30 of the E.C. Treaty. In *Beentjes* the ECJ considered the issue of non-discriminatory contract conditions. It was held that it was possible to include contract condition relating to the employment of long-term unemployed provided certain conditions were met: "it had no direct or indirect discrimination on tenderers from other member states; it met the criterion of transparency; it was not used as a selection or evaluation criterion but was applied after award."

⁵¹ See above section 3.3.3.

⁵² Digings/Bennet, op.cit., note 2 of ch.1, para B3.13; it is furthermore noteworthy that E.C. Competition Law may become relevant since the Commission has held that the imposition of unreasonable terms and conditions is an "abuse of a dominant position" under Article 86(1) E.C. Treaty, (*Third Report on Competition Policy*, para 68-69).

⁵³ "Private matters that draw public interest" in: *Evening Standard*, 05 May 1999.

invitation to negotiate.⁵⁴ Providers refusing to accept the standard contract and the proposed risk allocation were ejected from the authority's shortlist. The Treasury⁵⁵ and the NHS Executive have endorsed this practice.⁵⁶ The NHS guidance note on Public Private Partnerships⁵⁷ clearly states that the use of the standard contract is mandatory and its key commercial terms must not be varied. The guidance further suggests that the acceptance of the standard form contract should be considered at the preliminary ITN stage.⁵⁸

Shortlisting criteria must be suitable to examine either the providers' financial standing, its technical capability, ability, or its compliance with legal requirements listed in the Directive. The acceptance of standard contract terms could be viewed as a minimum technical standard for those participating in the contract. It appears questionable whether the criterion is suitable to assess the technical capacity of the providers. For example, a contractor may well have sufficient manpower and experience to perform the contract, but would prefer to negotiate over risk allocation. In this situation, the bidder is technically capable of performing the contract, but does not meet the "acceptance of standardised contract" criterion. A requirement to accept contract templates is equally unrelated to the "skills, efficiency, experience and reliability." Hence, it cannot be viewed as a suitable criterion to assess the providers' "ability." It can be concluded that the practice of allocating evaluation marks at the shortlisting stage on the basis of conformity with contractual templates is not compatible with the procurement rules.

This conclusion does not imply that the contracting authority may not expel those tenderers from the bidding process which are not prepared to accept standardised

⁵⁴ Such contract templates as regards to the allocation of substantial risks is rather the exception as rather non-contentious issues are subjected to standardised treatment.

⁵⁵ This is practice is indicated in H.M. Treasury, op.cit., note 15 of ch.2 (preferred bidder), at para 4.3.1: "[...] it is important that a potential preferred bidder accepts, and the price reflects, the key contractual terms that forms the basis of the agreement between the parties."

⁵⁶ *Ibid.* at paras 5.26-5.30.

⁵⁷ NHS Executive, op.cit., note 44 of ch.2 (good practice guide), paras 5.1 and 5.2.

⁵⁸ *Ibid.* paras 5.59, 5.68.

contract terms. Bidders submitting a tender expressly on the basis that they do not wish to conclude an agreement on the standardised terms, will have to be excluded from the award procedure.⁵⁹ Their bids are not compliant with the substantive requirements of the contract to be awarded. This is unproblematic provided that the contract templates are designed in a non-discriminatory and transparent way.

The third shortlisting criterion used in PFI is related to the long-term nature of Public-Private Partnerships. Partnerships are formed on the basis that public and private sector will strive together towards creating a mutually beneficial “win-win” situation. It is therefore hardly surprising that contracting authorities have been inclined to evaluate at shortlisting stage the ability of providers to form good working relationships. In fact, the long-term commitment of the parties can be regarded as the central requirement for the success of PFI projects.⁶⁰ Authorities prefer to discuss with suppliers the requirements of the contract at an early stage of the procurement process. The relationship is then gradually deepened during the negotiation process and eventually should foster familiarity with the needs and capacities of both sides and a significant degree of commitment and trust.⁶¹

The rationale behind this quasi-partnering or non-adversarial approach⁶² is that sharing risks, expertise and information will result in greater efficiency and a speedy and less costly settlement of possible disputes.⁶³ Pursuing a non-adversarial approach can be viewed as one of the main principles underlying the Private Finance

⁵⁹ The acceptance of a non-compliant bid is not at the discretion of the contracting authority. The Court of Justice held in case C-243/89, *Commission v. Denmark*, [1993] E.C.R. I-3353 that the acceptance of a non-compliant bid is generally prohibited under the Directives.

⁶⁰ This and the other requirements of such long-term arrangements are comparable to the success factors in so-called “Partnering” approaches, cf. Saunders, *op.cit.*, note 135 of ch.2; Macbeth/Ferguson, *Partnership Sourcing* (1992); Trepte, *op.cit.*, note 188 of ch.3, p.204; Broomhall/ Lomas, “Partnering: An Acceptable Strategy for Utilities?” (1993) *P.P.L.R.* p.221; Heal, *op.cit.*, note 136 of ch.2, p.167.

⁶¹ It is suggested that this particularly means an exchange of information including open-book costing and giving customers access to the supplier’s accounts for cost-reduction projects; Partnership Sourcing Ltd, *Making Partnership Sourcing Happen* (1992).

⁶² “PFI is not a revolution; it is essentially partnering through limited recourse concession financing,” Cileenti, “Exploring the future face of procurement in Europe” (1999) *PFI Intelligence Bulletin* (Oct.).

⁶³ Broomhall/ Lomas, *op.cit.*, note 60, at p.223.

Initiative.⁶⁴ One can conclude from those basic considerations and the lessons learned from previous PFIs⁶⁵ that it appears economically sensible to evaluate bidders on their ability to form a good working relationship. The relevant shortlisting criterion has been termed “understanding of the issues involved”⁶⁶ and “senior management commitment.”⁶⁷

Recall that it is only permissible to shortlist candidates on the grounds established in the Directives.⁶⁸ Hence, the criterion of having a “good partnering relationship” needs to be translated in terms of the provider’s relative technical capability, financial standing or the fulfilment of miscellaneous legal requirements. Neither the “commitment” of a prospective provider nor the hardly measurable attribute of “understanding of the issues involved” or forming “good working relationship” fall within one of the permissible categories.

Assessing the ability of tenderers to form a successful partnering relationship may be permissible in the context of the “ability” criterion laid down in Article 32(1) of the Services Directive. The ability criterion provides authorities with the opportunity to assess bidders based on their “skills, efficiency, experience and reliability.” Arguably, the ability to form a good working relationship is a skill within the meaning of the Directive that can be proven by the ability to work in specific ways. For instance, the authority could request evidence supporting their ability to successfully implement supply-chain management. It should be possible to break down the skill to form good working relationships into a number of more specific and less vague skills. For the sake of greater transparency and accountability it therefore seems desirable to avoid the nebulous global criterion and to invoke the more specific

⁶⁴ H.M. Treasury, op.cit., note 8 of ch.2, para 1.03.

⁶⁵ It was one of the major lessons learned during the NISR2 project that “the relationship between the Agency and its contractors is crucial to success” Public Accounts Committee, op.cit., note 35, para 8 of the introduction.

⁶⁶ H.M. Treasury, op.cit., note 40 of ch.2 (DBFO Road Contracts), chapter 4; H.M. Treasury, op.cit., note 43 of ch.2 (OSIRIS), para 2.5 “genuine understanding of the “requirements.”

⁶⁷ H.M. Treasury, *The IND Caseworking Programme*, para 2.5

⁶⁸ European Commission, op. cit., note 70, para 6.2; Case 76/81 *Transporoute et Travaux v. Minister of Public Works* [1982] E.C.R. 417.

skills instead.

9.2.2. Award criteria

Subsequent to the selection of suitable candidates, the authority decides on the contract award. This decision must be either based on the “lowest price” criterion or the contract must be awarded to the bidder offering the “most economically advantageous tender.” Whilst it is obvious what is meant by the “lowest price,” the Directives specifically define the “most economically advantageous” criterion. According to the definition, the authority may consider “various criteria according to the contract in question, including price, delivery date, running costs, cost-effectiveness, quality, aesthetic and functional characteristics, technical merit, after-sale service and technical assistance.”⁶⁹

This list is not exhaustive. It is apparent from the examples given that only objective grounds may be used which are “equally applicable to all tenders, strictly related to the subject of the contract.”⁷⁰ Furthermore, the criteria should be “aimed at identifying the offer which is economically the most advantageous.”⁷¹ The specific criteria used in the award of the contract must be listed in either the contract notice or in the contract documents.⁷² Criteria which have not been publicised in this way may not be used to evaluate bids.⁷³

It is contested whether contracting authorities may consider other, so-called “secondary,” criteria besides the award criteria listed in the Directives, such as environmental or social issues. The discussion has been sparked by the *Beentjes* judgment where the Court of Justice held that “the Directive does not lay down a

⁶⁹ Article 26 Supply Directive; Article 30 Works Directive; Article 36 Services Directive.

⁷⁰ European Commission, *Guide to the Community Rules on Public Supply Contracts*, para 6.3; *Ibid.* *Guide to the Community rules on open government procurement* [1987] O.J. C358/1, para 36.

⁷¹ Case 31/87 *Gebroeders Beentjes v. The Netherlands*, [1988] E.C.R. 4653 para 19 of the judgment.

⁷² *Ibid.* para 21 of the judgment.

⁷³ Case 31/87 *Gebroeders Beentjes v. The Netherlands*, [1988] E.C.R. 4653 para 31 of the judgment; Case C-225/98 *Commission v. France*, judgment of 26 September 2000 (not yet reported) para 51 of the judgment.

uniform and exhaustive body of Community rules; within the framework of the common rules which it contains, the Member States remain free to maintain or adopt substantive and procedural rules in regard to public works contracts on condition that they comply with all the relevant provision of Community law...”⁷⁴

The Court further stated that authorities were free to exclude bidders on certain “additional specific conditions”⁷⁵ if those conditions were compatible with the principles underlying the E.C. Treaty. Further, they should “have no direct or indirect discriminatory effect on tenderers from other Member States” and should have been mentioned in the contract notice.⁷⁶ The judgment has been interpreted to mean that potential contractors are required to meet “additional specific conditions” set by the contracting authority, but they cannot be excluded from the process for not meeting them.⁷⁷ The European Court of Justice has rejected the interpretation that the specific conditions are criteria *sui generis*. The Court clarified the nature of the additional specific conditions as “necessarily constituting a criterion for the award of the contract.”⁷⁸

In the award phase, it may be permissible to consider employment related issues subsequent to consultation with staff representatives. Those issues include the comparison of employment track records, the application of TUPE, wages and conditions, labour relations, health, safety and training.⁷⁹ Considering those issues at the award stage is only permissible in cases where the employment history of the provider is “strictly related” to the subject of the contract and where the training or the payment of staff is of particular importance for the contract. This could be the case

⁷⁴ Case 31/87 *Gebroeders Beentjes v. The Netherlands*, [1988] E.C.R. 4653 para 20 of the judgment.

⁷⁵ *Ibid.* para 37 of the judgment.

⁷⁶ Case C-225/98 *Commission v. France*, judgment of 26 September 2000 (not yet reported) para 51 of the judgment.

⁷⁷ This interpretation has been favoured by the European Commission (COM (89) 400 final) and by advocate General Albert, Case C-225/98 *Commission v. France*, Opinion of 14 March 2000 (not yet reported), para 43 et seq. of the opinion.

⁷⁸ Case C-225/98 *Commission v. France*, judgment of 26 September 2000 (not yet reported), para 52 of the judgment, with annotations: Arnould (2001) *P.P.L.R.* NA13.

⁷⁹ H.M. Treasury, op.cit., note 14 of ch.2 (consultation with staff), para 4.3.1.

where for security reasons it is required that the staff is adequately trained and paid to ensure the delivery of the service without disruptions resulting from strikes or a high turnover of staff. Only under those circumstances it is permissible for the government department to consider employment related issues at award stage.

It can be deduced from recent European⁸⁰ and national⁸¹ case law that reference to employment related aspects is by no means an idiosyncrasy of complex procurement tasks, such as PFI. However, it is not possible to exclude tenderers from the bidding process at shortlisting stage on grounds not expressly mentioned in the Directives.

Recall that government departments are permitted to shortlist bidders for the reason of establishing industries in the various PFI sectors only under exceptional circumstances. Notwithstanding, authorities may be permitted to use the development criterion at award stage, as advised by the U.K. government.⁸² Criteria for the award of contracts must be capable to evaluate the provider's abilities to perform the contract for which qualification is sought.⁸³ It is submitted that the "non-quantifiable benefits"⁸⁴ of developing PFI industries are not closely related to the individual PFI agreement. They rather aim to further the PFI scheme as a whole. Hence, the "development of PFI industries" is not a permissible award criterion under the procurement Directives.⁸⁵

9.2.3. Overlap of shortlisting and award criteria

The European Court of Justice⁸⁶ and the European Commission⁸⁷ have

⁸⁰ For example, in Case C-225/98 *Commission v. France* (not yet reported), the French authority used the criterion of "development of employment opportunities."

⁸¹ For example in Germany: Kammergericht, Order of May 20, 2000 – (Kart 24/97), where the court held that the Senate of Berlin infringed procurement law, by awarding works contracts only to contractors which agreed to comply with the regional minimum wage rate of Berlin ("Tariftreueerklärung").

⁸² H.M. Treasury, op.cit., note 35, para 3.13-3.15.

⁸³ Cf. *R. v. Secretary of State for the Environment, ex p. London Borough of Harrow*, *The Times*, January 16, 1996; with annotations: Arrowsmith, (1996) *P.P.L.R.* CS152-156.

⁸⁴ NAO, op.cit., note 40 of ch.2, evidence of the witnesses, para 109.

⁸⁵ Arrowsmith, op.cit., note 2 of ch.1, pp.236-239, 625.

⁸⁶ Case 31/87 *Gebroeders Beentjes v. The Netherlands*, [1988] *E.C.R.* 4653 para 16 of the judgment.

⁸⁷ European Commission, op. cit., note 70 (public supply), para 6.1.1; European Commission, op.cit., note 59 of ch.3, para 3.23.

consistently demanded that contracting authorities should draw a clear distinction between the procedural stages of qualification and award. In view of that guidance, authorities are supposed to distinguish between the criteria to assess the suitability of the tenderer and those assessing the merits of the bid. The same applies in principle to shortlisting criteria. Government departments are therefore not permitted to shortlist potential contractors on the basis of award criteria.⁸⁸

Notwithstanding the clear-cut approach, H.M. Treasury⁸⁹ and the National Health Service (NHS) Executive⁹⁰ issued PFI guidance notes that do not properly distinguish between the two sets of criteria. The misleading government guidance includes a Treasury Taskforce guidance on design quality in PFI projects. The technical note expressly recommends the use of project-specific award criteria at shortlisting stage.⁹¹

What is more, the Treasury's step by step guide maintains that bidders can be shortlisted "on the grounds of ability and commitment to offer a viable and affordable bid for the job; approach taken, appetite for taking on the risk."⁹²

In the health sector, NHS guidance advises NHS Trusts that shortlisting criteria used in health related PFI projects should aim at "selecting the most economically advantageous offer."⁹³ From a procurement law perspective, the Treasury and the NHS Executive thereby recommend the employment of qualification and award criteria at the same evaluation stage and fail to distinguish the two sets of criteria.

9.3. Empirical findings

Interviewees were asked about the assessment criteria authorities employed in PFI. PubSA#8 perceived the assessment of bidders and their proposals was "the

⁸⁸ Braun, "Selection of bidders and contract award criteria: the compatibility of practice in PFI procurement with European Law" (2001) *P.P.L.R.* p.1.

⁸⁹ H.M. Treasury, op.cit., note 46 of ch.2, para 3.7; similarly: H.M. Treasury, op.cit., note 43 of ch.2 (IT – Practical guide), step 8; HM Prison Service/ Private Finance Panel, op.cit., note 72 of ch.2, para 5.5.

⁹⁰ NHS Executive, op.cit., note 44 of ch.2 (good practice guide), para 5.73.

⁹¹ Treasury Taskforce, op.cit., note 15 of ch.2 (design quality), paras 3.2 et.seq.

⁹² H.M. Treasury, op.cit., note 13 of ch.2, stage 8.

⁹³ NHS Executive, op.cit., note 44 of ch.2 (good practice guide), para 5.74.

second major area of tension” within the PFI procurement process, besides the use of the negotiated procedure. PubSA#8 said there was a

*“general uncertainty of how to move from a longlist to shortlist and then on to a preferred bidder.”*⁹⁴

PubSA#4 added that, in particular, the question of which criteria to use at the different stages was one of the most ambiguous issues in PFI procurement.

9.3.1. Selection of bidders

9.3.1.1. Pre-qualification and shortlisting criteria

Interviewees across all sectors typically said that the criteria used in PFI to pre-qualify bidders largely resembled the criteria permitted under the procurement rules.⁹⁵ Authorities employed the technical, financial and legal assessment criteria laid down in the Directives.⁹⁶ When applying the Services Directive, authorities had particular recourse to the “ability” criterion which then served as a broad heading to consider a variety of issues. PrivSA#6 insisted that financing issues were especially important in the assessment of bidding consortia. He added that authorities were especially interested in the parent companies providing guarantees for the consortium.⁹⁷

PrivSA#6 said that authorities have recently started to look very carefully at previous PFI experience of the consortia and their members. This was done to exclude those contractors from the bidding process which have not yet proceeded through the steep and costly learning curve.⁹⁸ Another qualification criterion was, mentioned by PubSA#4, related to the cohesiveness of the consortium. Authorities wanted to pre-empt the need to reassess consortia during the procurement process, which might become necessary should their composition change. Consortia were therefore asked to produce evidence of previous experience in working together.⁹⁹

⁹⁴ PubSA#8.

⁹⁵ PrivSA#1, BothSA#1, PubSA#1, PubSA#3 and PubSA#4.

⁹⁶ PrivSA#1; BothSA#1; PubSA#1; PubSA#3; PubSA#4.

⁹⁷ PrivSA#6.

⁹⁸ PrivSA#6.

⁹⁹ PubSA#4.

PubSA#4 maintained that authorities also used criteria which were more difficult to reconcile with procurement law. She remarked that, in particular, the “ability” criterion of the Services Directive was employed to ask bidders about their employment and labour relations, the application of TUPE to the prospective project, pension entitlements and “all kinds of odd things.”¹⁰⁰ Drawing from her extensive experience in the health sector PubSA#4 added that NHS Executive guidance was expressly requesting NHS Trusts to ask bidders about employment related matters during the qualification exercise.

PubSA#4 complained that some standard qualification questionnaires expressly asked for the bidders’ initial proposals on the project.¹⁰¹ She thought requiring project related information at pre-qualification stage was clearly not reconcilable with the procurement rules, albeit that the information contained in the “outline proposals” was limited to between two and four sides of A4 pages.¹⁰² PubSA#8 confirmed the existence of this practice and added that some authorities requested project related information in the course of assessing the bidders’ technical capability. PubSA#8 thought this was a clear breach of the rules. However, she failed to dissuade her public sector clients from engaging in the practice.

Other authorities and law firms used a two stage pre-qualification process employing project related criteria, which PubSA#8 considered equally dubious. Commenting on those practices, PubSA#4 said that it was a matter of time before a bidder would challenge authorities on requesting project related information at qualification stage.¹⁰³

On the issue of requesting project related information, three legal advisors reported “falling-outs”¹⁰⁴ and “tensions”¹⁰⁵ between them and their public sector

¹⁰⁰ PubSA#4.

¹⁰¹ PubSA#4.

¹⁰² PubSA#4.

¹⁰³ PubSA#4.

¹⁰⁴ PubSA#3.

¹⁰⁵ BothSA#3; PubSA#10.

clients. PubSA#10 mentioned additional tensions between legal and financial advisors, because the latter urged the departments to request project specific information. Legal advisors supported a “rigid” stance on this issue. PubSA#3 explained that “this is one of the areas where you have to be open and clear about where are you going and stick to the rules.”¹⁰⁶ As a consequence, her pre-qualification questionnaire was as close as possible to the E.U. Directives, “going in a bit more detail.”

Not all advisors shared this meticulous approach. PubSA#10 explained that if the authority and the financial institutions insisted on using their own shopping lists, she would merely “try to make them legal.”¹⁰⁷ PubSA#4 sought to adopt a similar approach in order to accommodate the expectations and wishes of her public sector clients. She tried to convey to her clients that if they illegitimately requested information, they had to give it a lower weighting.¹⁰⁸ However, she was aware that this did not render the practice lawful.

As regards to the shortlisting stage, four specific shortlisting criteria were discussed with the interviewees, namely employment related issues, the compulsory use of standardised contract terms, the willingness to form a good working relationship, and the development of PFI industries.

The first shortlisting criterion specifically considered was the role of staff consultations during the procurement process and their influence on evaluating bidders and their proposals. PubSA#3 observed the main concern of staff members was the transfer of public pensions. The private sector could not provide equivalent pensions because public sector pensions were final pay pensions. PubSA#3 said rules were included in the recent local government Regulations providing transferred employees with the opportunity to remain in the local government pensions scheme. PubSA#3 added that it was likely the NHS would adopt a similar approach in the near future.¹⁰⁹

¹⁰⁶ PubSA#3.

¹⁰⁷ PubSA#10.

¹⁰⁸ PubSA#4.

¹⁰⁹ PubSA#3.

All participants agreed that staff issues and staff consultations were generally treated very seriously. This practice was required by TUPE and TTF guidance.¹¹⁰ PrivSA#6 observed that staff issues were also high on the agenda because the public sector was a responsible employer. Government departments sought to ensure that employees were well transferred and looked after. In addition, authorities were interested to keep a lid on political and union opposition to the entire PFI concept. PrivSA#3, PubSA#3 and PubSA#4 said the involvement of staff representatives in the discussion of employment related issues varied substantially between sectors and depended on the quality of the industrial relations.

PrivSA#3 provided the study with a practical examples. In one NHS scheme, the awarding trust involved staff at the pre-qualification stage to the extent that staff representatives gave responses to the pre-qualification questionnaire returned by bidders.¹¹¹ PubSA#3 observed that in some cases staff members were consulted before an OJEC was placed. Authorities sought to avoid possible disruptions of the procurement process by members of staff who felt their jobs were at risk. Another way of involving staff members in the procurement process was to admit staff or union representatives to the project board.¹¹²

The “acceptance of standardised contract terms” was the second questionable shortlisting criterion discussed with interviewees. PubSA#3 remarked that the use of standardised terms was normally mentioned in the project’s information memorandum at the very early stages of the procurement.¹¹³ PrivSA#6 mentioned that NHS Trusts routinely asked bidders at shortlisting stage to indicate whether they were willing to agree on the standardised contract terms.¹¹⁴

¹¹⁰ PubSA#1; PubSA#3; PrivSA#6; PubSA#8.

¹¹¹ PrivSA#3.

¹¹² PubSA#3.

¹¹³ PubSA#3.

¹¹⁴ Recall that, according to the NHS guidance, the shortlisting procedure takes place prior to issuing of the ITN.

All lawyers with experience in the health sector knew of this practice and thought it was irreconcilable with the procurement rules. Private sector advisors were specially infuriated by the “ruthless macho behaviour”¹¹⁵ demonstrated by the NHS Private Finance Unit (PFU). Even lawyers without previous health sector experience, such as PubSA#4, were “appalled” by this practice. Three public sector advisors mentioned “a very strong pressure from the Trusts on the bidders”¹¹⁶ to accept the standardised terms. PubSA#9 maintained that NHS Trusts allocated evaluation marks according to the willingness of bidders to accept the contract templates.

PrivSA#6 described the standardisation document of the health sector as hardly acceptable to private sector contractors. The document did not represent best value for money, because there were many risks the parties had to negotiate and if the banks would refuse to cover them, equity had to cover them instead. This resulted in a higher percentage of equity and a lower percentage of debt than necessary. PrivSA#6 explained that the rate of return on equity was 15%, while the interest to be paid on bank debt was 5%. The difference would equal the increase in cost. In other words, standardised contract terms increased the project costs and made “the banks unhappy.”¹¹⁷ He further argued that it appeared difficult to justify the use of the negotiated procedure, if the authority was able to determine the standardised risk allocation at the outset of the project. Using the negotiated procedure was in the public sector interest, because it helped to squeeze the best value for money out of the bidders.¹¹⁸

PrivSA#3 observed that the public sector had historical reasons to insist on its standardised terms. In the early days of PFI, “badly prepared” and “badly advised”¹¹⁹ NHS trusts were routinely disadvantaged in contract negotiations by more sophisticated bidders. Hence, from the viewpoint of the NHS standardising

¹¹⁵ PrivSA#6.

¹¹⁶ PubSA#1; PubSA#3; PrivSA#3.

¹¹⁷ PrivSA#6.

¹¹⁸ PrivSA#6.

¹¹⁹ PrivSA#6.

imperfection was preferable to becoming “routinely rolled over by the private sector.”¹²⁰

Lawyers interviewed in this study wondered at which stage the “acceptance of standardised terms” criterion could be legitimately employed. PrivSA#6 held it was not an apt criterion to assess the capability of the bidder to deliver (qualification criterion). BothSA#3 said it was illegitimate to ask this question at either pre-qualification or shortlisting stage. He added that one might raise the issue when assessing the affordability and price of the project. BothSA#3 argued that if the contractor refused to accept the standardised terms, this inevitably increased the project cost. PrivSA#6 raised the important question whether it was permissible for the authority to expel an otherwise qualified bidder from the shortlist on this ground.

BothSA#2 mentioned that in order to avoid this dilemma, other government departments normally invited the submission of alternative bids and variant proposals. The authorities sought to realise best economic value rather than the lowest price. BothSA#2 said this was especially important in the PFI sector where the government department wanted to achieve innovative solutions.

*PrivSA#6 approved this practice and remarked that it was very difficult to force standardised contract terms on bidders because, inevitably, contractual and factual aspects changed. The project first tendered was always quite different from that on which the contract was awarded. Imposing standardised contract terms on bidders could therefore easily result in receiving non-compliant bids.*¹²¹

The third specific shortlisting criteria discussed with the respondents was the “ability to form a good working relationship.”¹²² PubSA#4 reported that bidders had to sign contractual arrangements that they were prepared to enter into a “partnering relationship based on good faith and mutual trust, openness and reasonableness.”

¹²⁰ PrivSA#6.

¹²¹ PrivSA#6.

¹²² PubSA#1 .

Lawyer respondents¹²³ were generally dissatisfied with using the “partnering” or similar criteria,¹²⁴ because it lacked substance.¹²⁵ They suggested better ways of pinpointing the precise issues behind the vague term. For example, PubSA#3 and PubSA#10 proposed the authority could assess proven ability to establish a system of supply-chain management. The bidders could also be asked to provide practical examples of problem solving in an existing partnering arrangement.¹²⁶ BothSA#2 suggested that authorities should look at the bidders’ proposals for joint working, lines of communications, proposals for workshops and team building.

PubSA#4 and PubSA#10 doubted whether it was commercially sensible to ask questions surrounding “good working relationships” before the ITN stage. Both legal advisors argued that bidding consortia were of rather loose cohesiveness and their members “would change anyway.”¹²⁷ Frequent changes in the composition of consortia would undermine assessment criteria based on working relationships between the authority and particular consortium members. Despite its questionable usefulness, PrivSA#3 felt that private sector suppliers favoured this criterion, perhaps because it gave them the opportunity to learn about the project and the project team.

With respect to the fourth shortlisting criterion of “developing PFI industries” only PrivSA#5 and BothSA#4 were aware of any bias against firms that were already operating PFI contracts. The occurrence that not more lawyers knew of the bias is partly because some of them were not involved in advising on the very early PFI projects and specialised in PFI only later.¹²⁸ Others did not become involved at the evaluation stage.¹²⁹ However, this practice is well documented *inter alia* in NAO Reports on early prison and highway projects.

¹²³ PubSA#1, PubSA#3, PubSA#8, PubSA#9 and PubSA#10.

¹²⁴ PubSA#1; PubSA#3; PubSA#8; PubSA#9.

¹²⁵ PubSA#4.

¹²⁶ PubSA#3; PubSA#10.

¹²⁷ PubSA#4.

¹²⁸ PubSA#1.

¹²⁹ PubSA#8.

9.3.1.2. Shortlisting practice

When structuring the award process and deciding which criteria to employ at which stage, lawyers found themselves in a precarious situation. On the one hand, they are confronted with official guidance notes and the wishes of their clients to proceed swiftly and efficiently through the procurement process. On the other hand, they were aware of the clear cut approach taken by the procurement rules.

BothSA#1 and BothSA#3 remarked that they analysed the risks involved in shortlisting bidders on the grounds of award criteria. They concluded that the risk of being challenged was low, because the Treasury and other governmental departments recommended this approach as “best practice.” Bidders were said to have a self-interest in presenting themselves and their bids in the most positive manner. However, the experiences and approaches of respondents differed. Lawyers such as PubSA#3 risked falling out with clients by insisting on strict procedural propriety. Others, such as BothSA#2, preferred to find a compromise between the rules and the wishes of their public sector clients.

PubSA#8 reported uncertainty amongst PFI awarding authorities and their legal advisors as to which criteria should be employed to shortlist pre-qualified bidders. Uncertainty partly arose because the sector specific guidance notes, the TTF notes and the academic literature applied the term “shortlisting” to different stages of the procurement process. PubSA#4 and PubSA#9 thought that the uncertainty surrounding the term gave rise to the illegitimate use of award criteria at shortlisting stage, irrespective of when this stage occurred in the process. PubSA#4 nonetheless defended current practice and said that neither the Directives nor the academic literature have yet come up with a workable solution to the problem.

The conduct of successive rounds of bid assessments nourishes the uncertainties surrounding the shortlisting exercise. What is more, government guidance notes

employ different terminologies.¹³⁰ Tenderers are whittled down at “shortlisting,” “ISOP,” “pre-ITN” and “ITN” stages, depending on the PFI sectors.

PubSA#3 confirmed that the confusion created by government guidance resulted in an inconsistent practice. In addition to the uncertainties surrounding terminology, the Treasury recommends requesting “mini-proposals” from bidders at shortlisting stage. Whilst some departments sought outline proposals at the pre-qualification stage, other government agencies seemed to mix up the proposals with qualification criteria at the “ISOP” (third selection stage), “pre-ITN”¹³¹ or “ITN” stage. This confusion of terms and criteria has further repercussions. Although diligent attempts were made to clarify the applied processes during the interviews, it sometimes remained unclear whether lawyers really meant “shortlisting” as it is discussed in the academic literature.

Representing many of the interviewees, PubSA#10 described the shortlisting process as it is suggested in the government guidance. She perceived shortlisting as part of the negotiation process. The government departments had to use project specific criteria, because they needed to understand whether a particular consortium could undertake a particular project. This information could not generally be inferred from a list of the projects the consortium had previously delivered. This is why authorities and their legal advisors preferred to conduct an ISOP stage. This took place subsequent to pre-qualification and before the authority entered into further negotiations with half a dozen or so contractors. Bidders were then ejected through the different stages of ISOP,¹³² ITN¹³³ and BAFO.¹³⁴

It can be inferred from PubSA#10’s account, other interviews and government guidance notes that it is common PFI procurement practice to shortlist bidders prior to the invitation to negotiate (ITN) in the meaning of the directives. PubSA#10 and other

¹³⁰ Cf. above.

¹³¹ PubSA#3.

¹³² Invitation to submit outline proposals.

¹³³ Invitation to negotiate.

¹³⁴ Best and final offer, PubSA#10.

interviewees perceived the shortlisting stage as part of the negotiations. At that stage, the authority has not yet formally invited the tenderers to negotiate by issuing ITNs. According to the Directives, the ITN is a watershed between pre-qualification and negotiation. Two distinct sets of criteria are to be employed at each stage. To use award criteria before the negotiation round has formally commenced with the ITN therefore contravenes the procurement rules.

This was recognised by PubSA#8 who questioned the legitimacy of the ISOP or pre-ITN stage altogether. In her view, the procurement process effectively included two stages, a pre-qualification and a tendering stage. She added that it was difficult to see how it was possible to have an outline proposal stage right after the pre-qualification stage. This would only barely be feasible as a first phase of the ITN stage.¹³⁵

Only a minority of lawyers, including PubSA#3, PubSA#8 and BothSA#3, was very clear about the different stages and the issues involved. They said they conveyed their clients the significance of the different stages by clearly separating the pre-qualification from the negotiation phase.¹³⁶ BothSA#3 insisted that it was only in the latter stage that authorities were allowed to employ more project specific criteria and that it was up to the authority how it structured this phase.

PubSA#7 employed the following distinction. Final award criteria were forward-looking, whilst up to the shortlisting stage the authorities were supposed to look backward at historical issues. This assessment included questions such as whether bidders paid their taxes and what happened on other projects they had worked on in the past. Only post-qualification, authorities were permitted to apply their forward-looking criteria which related to the project and nothing else. Before the commencement of the negotiations, it was not legitimate to employ forward-looking award criteria.

¹³⁵ PubSA#8.

¹³⁶ PubSA#3; BothSA#3.

Other lawyers, such as BothSA#1 and PubSA#4, responded that they applied award criteria at the procedural stage following pre-qualification. BothSA#1 was aware that this practice was not reconcilable with the procurement rules.¹³⁷ He adopted this cavalier approach towards procurement law, because he felt bidders would not challenge his public sector clients on the decision to use both sets of criteria at one stage. In similar vein, BothSA#2 remarked that at shortlisting stage he looked at relevant project experience, the financial information, consortium members, and their track-records. He also used mini-proposals, as advocated by the Treasury guidance. He expected to request such information in any event at that stage. The response of PrivSA#6 showed that not all legal advisors were aware that this practice was not reconcilable with procurement law. PrivSA#6 blatantly mixed up the distinct sets of criteria by explaining that as long as the authority used the phrase “most economically advantageous” coupled with experience, technical capability, and financial stability, the government department could apply any criteria.

PubSA#4 explained that although this practice might be difficult to reconcile with procurement law, it played an obvious commercial role. This is why the NHS guidance insisted on conducting a pre-ITN stage at which the NHS Trusts require project specific information. BothSA#3 reported that amongst those project related issues were “silly questions,” such as “what do you think of my project,” “what is your design approach” and “will TUPE apply.”¹³⁸ BothSA#3 described the situation where a public sector client insisted on requesting this kind of information against his legal advice. “Quite often,” he said, “you just give in because then you are analysing the risk of being challenged which is negligible.” The main factors considered in the analysis of risks will be dealt with in chapter 12.

¹³⁷ BothSA#1.

¹³⁸ BothSA#3.

9.3.2. Award criteria

9.3.2.1. Vagueness of award criteria

All lawyers interviewed agreed that the universally used award criterion in PFI is “most economically advantageous bid.” Authorities sought to avoid being too specific with respect to the award criteria and their weighting. A common complaint from legal advisors, such as PubSA#3, was that as a result government departments failed to make up their minds about what award criteria to include. BothSA#3 described this behaviour as “endemic across the public sector.” Authorities were said to avoid concrete evaluation models and did not want to pin themselves down to weightings or sub-weightings.

9.3.2.2. Changing of award criteria

BothSA#3 mentioned that authorities were inclined to change evaluation criteria. This would allow them to take the bidder they wanted rather than the person they were supposed to choose on objective grounds.

Even if lawyers did not always seem to convince their public sector clients to follow legal advice, PubSA#3 did not experience changes to the award criteria and claimed to be quite strict with her clients on this issue. PrivSA#6 remarked that award criteria remained unaltered mainly because they were published amongst the bidders and subsequent changes were easy to detect.¹³⁹

In addition, publishing only broad headline award criteria allowed the authority to work out later in the process what those headings meant in detail and thereby reduced the need to change award criteria. PubSA#3 gave the example of an authority which sought to evaluate the quality of the support service, but did not know at the beginning of the process what the support services were going to be. The criteria therefore had to be refined throughout the process. PubSA#3 added that authorities occasionally rushed into the procurement process. As a result, they forgot to list “quality” or a similarly

¹³⁹ PrivSA#6.

essential criterion when drafting their information memorandum. Under those circumstances, the legal advisors had to have recourse to other criteria to accommodate the pertinent assessment of quality. If one criterion was technical expertise or value for money, than quality became an element of the value for money consideration. PubSA#3 concluded that going ahead without looking at quality issues was as impossible as re-starting the process from scratch, because “the auditors would hang them for that.”¹⁴⁰

Nonetheless, PubSA#4, PubSA#8 and PubSA#10 all mentioned problems in persuading authorities to stick to the same broad headline award criteria between the ISOP and final award stage. They concluded this was another area where tensions arose between the legal advisors and their public sector clients.

9.3.2.3. Nature of the award criteria

Some of the award criteria used in PFI were not reconcilable with procurement law. Two of them, the development of PFI industries and employment related issues, have been discussed with respondents. Apart from using employment issues at pre-qualification and shortlisting stage, staff members were also consulted throughout the award process.

PubSA#4 gave a practical example where staff members were briefed during the negotiation process. Their representatives posted the design of the competing bidders on staff notice boards. Though union representatives were not regularly involved in the award process, PubSA#4 suspected that soundings were taken. She thought this was detrimental, because the authority was easily creating expectations amongst staff that their views would be listen to. This was in fact not the case. The authority was bound to apply the evaluation criteria and those criteria did not include the opinion of staff members on design issues.¹⁴¹ PubSA#9 was clear about the fact that staff

¹⁴⁰ PubSA#3.

¹⁴¹ PubSA#4.

representatives should not play any role in evaluating bids. She advised her clients accordingly.

Even if such a strict approach was adopted, PubSA#8 and PubSA#10 suspected that staff representatives influenced the procurement decision through internal communication channels and had their black or red book about private firms. Public sector advisors identified this issue as an area where tensions arose between them and their public sector clients. BothSA#3 mentioned all authorities wanted to keep the unions happy and government guidance, including the NHS guidance, mislead departments on the issue.

From the perspective of the private sector, PrivSA#6 said the ability to convince employees that the proposal of the bidder was a better idea than the automatic transfer under TUPE was an essential skill to win the contract. In particular in the facilities management (FM) area where a large number of staff was transferred, the ability to convince and then to deliver improved the job opportunity dramatically.

9.4. Findings

The results of chapter 9 are mainly twofold. Firstly, governmental guidelines encouraged authorities to mix up procedural stages. As a result, authorities used award criteria at shortlisting stage before issuing the ITN. Mixing up the two distinct sets of assessment criteria is irreconcilable with procurement law. Though the reasons for this practice will be discussed in chapter 12, it can be asserted that the practice was at least partly caused by unclear terminology.

Secondly, authorities routinely disregard the procurement rules when deciding which criteria to employ in the pre-qualification, shortlisting and award process. Apart from the development of PFI industries, PFI awarding authorities regularly employed questionable qualification, shortlisting and award criteria which did not derive from the procurement Directives. It is one result of the empirical study that legal advisors

had instead recourse to TTF guidance,¹⁴² the clients' "shopping lists,"¹⁴³ sector specific guidance,¹⁴⁴ the lists of the project lenders¹⁴⁵ and, most importantly, to project specific considerations.¹⁴⁶

There is considerable evidence that authorities and their legal advisors viewed the procurement Directives as one source amongst others when they chose the criteria. This finding explains why government departments considered other criteria, such as partnering, staff issues, the acceptance of standardised contract terms and the development of PFI industries. The motivation of authorities using the criteria against their better judgment have to be explored in chapter 12.

From an outsider perspective it is possible to conclude that procurement law has had significant impact only on the choice of pre-qualification criteria. The study could not provide evidence suggesting that authorities employed pre-qualification criteria different from those envisaged by the Directives. Conversely, regarding the procedural stages and the criteria applicable at shortlisting and award stage, it can be deduced that procurement law had only limited impact on the procurement practice.

Prevailing practices are compatible neither with the procurement Directives nor with the principles underlying them. The reason why authorities adopt the non-compliant behaviour include that it provides them with greater procedural flexibility and arguably accelerates the procurement process. For example, considering the bidder's ideas and proposals at the shortlisting stage has certainly helped authorities to arrive at a more informed commercial decision.

Equally, consultation with staff members and the insistence on standardised contract terms may have helped to prevent potentially difficult issues that otherwise could have prolonged the negotiation and implementation of the project. In addition, PubSA#8 described a "general uncertainty of how to move from a longlist to a

¹⁴² Inter alia: PrivSA#6; PubSA#8.

¹⁴³ PrivSA#1; PubSA#4 (MOD); PubSA#10.

¹⁴⁴ PubSA#9.

¹⁴⁵ PubSA#10.

¹⁴⁶ PrivSA#1; BothSA#1; PubSA#1; PubSA#3; PrivSA#6; PubSA#6; PubSA#4.

shortlist” which partly results from an unclear terminology and is reflected in the apparent mixing up of the applicable criteria.

The problems which are yet unresolved include the question of why the law failed to make an impact on the PFI procurement practice. It is suggested that this question for the reasons of non-compliance may overarch the seven procedural problems and we shall therefore return to it in chapter 12.

Chapter 10 Treatment of consortia

10.1. Introduction

The range of skills required meeting the obligations under a major PFI contract are too manifold to be delivered by only one undertaking. This is the reason why companies from a wide range of disciplines commonly create consortia set up only for the purpose of bidding for projects under the PFI scheme.

10.2. Treatment of consortia – the legal problems

Consortia are loosely structured joint ventures of private firms, the consortium members, bidding together for a PFI opportunity. The joint venture of private sector companies initially lacks legal capacity. The lack of legal capacity can pose difficulties when the authority assesses the financial and technical capacity of the consortium (10.2.1.) and the deliverability of its bid (10.2.2.). The loose cohesiveness of the consortium is reflected in the occurrence that the composition of such a joint venture frequently changes during the bidding process. Changes in the composition of the membership increase the difficulties for the authority to assess the merits of the bid and the capability of the newly established consortium (10.2.3.).

Once the consortium is awarded the project agreement it will divide the individual sub-contracts between its members according to their skills. Whether the consortium is possibly coming under the umbrella of procurement law and consequently has to advertise those intra-consortium contracts will be discussed in section 10.2.4.

10.2.1. The legal status of consortia

It is only at the final stages of the award procedure that consortium members formalise their co-operation by establishing a special purpose vehicle (SPV), in which they jointly own the shares. The treatment of consortia and special purpose vehicle in the procurement process is problematic for the reason that the one-off joint ventures are frequently set up by firms only to co-operate in a single project. Hence, in the

initial bidding stages the consortium generally lacks legal capacity. Moreover, it will have difficulties to produce evidence of the technical or financial qualification required to provide large-scale projects to the public sector.

The lack of legal capacity and the difficulties in assessing the merits of the bid could result in a less favourable treatment of consortia vis-à-vis other bidders. This is because the authority is interested to contract with parties which can assume obligations and may be held responsible for omitting or neglecting these obligations.

The U.K. Works Regulation 19, Supply Regulation 20 and Services Regulation 19 expressly state that “a contracting authority shall not treat the tender of a consortium as ineligible nor decide not to include a consortium amongst those persons from whom it will make the selection of persons to be invited to tender for or to negotiate a public... contract.”¹ Authorities are therefore prohibited to reject a bid submitted by a consortium only because the latter has not yet formalised the joint venture by establishing a legal entity.

Pursuant to Works Regulation 19(2), Supply Regulation 20(2) and Services Regulation 19(2) authorities may require² from the consortium to assume a specific legal form “when it has been awarded the contract,” meaning before entering into the PFI project agreement.³ This general rule appears to mirror an appropriate balance of the interests involved. The consortium members are not obliged to form a legal entity before being awarded the project contract, because such a requirement would inevitably increase transaction costs of the bidders. Conversely, the public authority has the appropriate legal certainty to enter into an agreement with an entity having legal personality and is fully accountable.

It is contentious whether national authorities can circumvent this rule simply by

¹ The equivalent European provisions: Article 18 Supply Directive; Article 21 Works Directive; Article 26 Services Directive; Article 33 Utilities Directive.

² The Supply Regulation furthermore requires that this is “necessary for the satisfactory performance of the contract.”

³ Arrowsmith, *op.cit.*, note 2 of ch.1, p.348; for the difference between the award of a contract and its closure see: *C-81/98 Alcatel Austria AG v Bundesministerium für Wissenschaft und Verkehr* (unreported), judgment of 28 October 1999.

making legal capacity a condition of participation. The Court of Justice held that authorities are not entitled “to seek other references than those expressly mentioned in the Directive.”⁴ Therefore, authorities are precluded from obliging bidding consortia to adopt a certain legal form prior to the award of the contract. It is permissible for the authority, according to Regulation 14, to ask providers to register in a national professional or trade register.

10.2.2. Assessment of consortium bids

Where consortia or a newly created SPV bid for a PFI contract, difficulties arise for the authority at the initial qualification stage. The difficulties usually occur because the consortium or the SPV lacks technical expertise and its financial standing is likely to be weak. The question arises whether the authority is entitled or required to consider the technical capacity and financial standing of the shareholders of the SPV, rather than the track record and financial standing of the SPV itself.⁵

This issue arose in the *Ballast Nedam* case⁶ where the European Court of Justice argued it was possible for the authority to consider the technical capacity/capability and the financial standing of consortium members. The *Ballast Nedam* case was concerned with the assessment of a holding company which did not perform any services itself but which responded to the advertisement in the Official Journal.

The ECJ held the authority could not exclude the holding company on the ground that it did not have any experience of performing the relevant services. This was held provided the holding company could produce references that it had available the resources of its subsidiary companies which did have the technical capability and knowledge of carrying out the works. According to the Court, those resources had to be assessed by reference to the usual technical, financial and legal criteria for

⁴ C-71/92 *Commission v. Spain* [1993] E.C.R. I-5923, at p.5989.

⁵ H.M. Treasury/ Treasury Taskforce, *Private Finance and IT*, para 4.

⁶ Case C-389/92 *Ballast Nedam* [1994] E.C.R. I-1289; Case C-5/97 *Ballast Nedam II*, judgment of 18 December 1997.

participation as laid down in Article 24 to 27 in the Works Directive.⁷

What is more, Article 27 (e) expressly mentions the possibility of proving the bidder's capacities by means of “a statement of the technicians or technical bodies which the contractor can call upon to carry out the work, whether or not they belong to the firm.” Having reference to this article, the Court ascertained⁸ the legal link between holding and subsidiary, respectively between SPV and its shareholders, was irrelevant. It was rather required that the holding “actually has available the resources of the latter which are necessary for carrying out the contracts.”⁹

The Court of Justice's view is reflected in the amendments of Directive 88/295 to the original definition of public works. According to the new definition, “works” encompass “the execution, by whatever means, of a work corresponding to the requirements specified by the contracting authority.”¹⁰ The Court inferred from this amendment in the *Ballast Nedam I* case that a person who did not intend to execute the works by itself or did not own the means to do so, could still participate in a contract award procedure.¹¹ Hence, where the SPV or the consortium can produce reference to the authority that it has available the technical and financial means of a particular or all of the consortium members, the authority has to consider those as resources of the SPV.

From the *Ballast Nedam* judgments the question arises of what evidence is required to establish the availability of the resources of the consortium members to the SPV.

The way in which a consortium establishes that it has the resources of its members available will vary from case to case. The ECJ ascertained in *Ballast Nedam* that it was up to national courts to determine whether the required evidence was provided. In most instances, the SPV will not be able to establish this availability

⁷ U.K. Works Regulation 14–16.

⁸ Case C-389/92, *Ballast Nedam I*, at para 17 of the judgment.

⁹ Case C-5/97, *Ballast Nedam II*, at para 12 of the judgment.

¹⁰ Art 1(c) Works Directive.

¹¹ Case C-389/92, *Ballast Nedam I*, at para 14 of the judgment.

simply by virtue of the fact that the shares in the SPV are owned by the consortium members. This is because under English company law, a company has no power to require its shareholders to perform the obligations of the company. Instead, the authority should seek to obtain evidence of contractual commitments from the consortium members.

As consortia have started to bid repeatedly in the same or at least similar composition for PFI projects, they increasingly acquire an own technical and financial track record. The aforementioned problems in assessing bids of consortia are therefore likely to diminish. PFI thereby indirectly helps to restructure the private sector in persuading companies to apply more efficient methods of collaboration when bidding for public contracts.¹² It is likely that this will encourage the introduction of modern methods of collaboration outside the realm of government procurement.

10.2.3. Changes in consortium membership

Apart from the problems caused by the legal status of consortia and the related question, changes to the commercial identity of the consortium may significantly effect the interests of the awarding authority.¹³ The changes may include the replacement or withdrawal of one or even more members and a change of ownership.¹⁴ For instance, a consortium member with an exceptionally convincing track record and outstanding financial capacity may decide to withdraw from the consortium. This withdrawal is likely to influence the assessment of the technical and financial capacity of the consortium.

The main question arising after a change in the composition is whether the authority is permitted or required to exclude the consortium from the bidding process. In the absence of any express rules in Directives, the principle of equal treatment requires that all tenderers have to be treated equally unless there are objective reasons

¹² CBI, op.cit., note 98 of ch.2, chapter 4 “Fostering private sector capacity.”

¹³ Highway Agency, op.cit., note 16 of ch.2, para 2.8.

¹⁴ *Ibid.*, cf. the M1-A1 road project where one consortium member was subject to a take-over bid and another carried out an asset swap (including its road business).

for discrimination. It is a fundamental requirement that all tenderers are judged against the same minimum qualification and shortlisting criteria. This implies that a changed consortium has to satisfy the minimum qualification, shortlisting and award requirements.

In cases where the new consortium member does not change or changes only slightly the quality of the consortium's bid and the status of the consortium in terms of qualification and shortlisting criteria, the authority should be permitted and indeed required to retain this bidder in the award procedure. In case of material changes to the consortium's composition which influence its technical or financial capability, the changes may eventually result in the consortium not meeting the qualification, shortlisting or award criteria. Under those circumstances, the consortium has to be ejected from the tendering process. To retain bidders on a long- or shortlist on an other basis than that previously applied to other tenderers contravenes the equal treatment and the transparency principle.¹⁵ It will be difficult in practice to prove that the tenderer under consideration would have been selected in its new composition.

10.2.4. Intra-consortium contracts

Following the award of the main PFI contract, the SPV will commence to place the different sub-contracts for the design, construction, management and operation of the asset to its members in accordance with their respective expertise. As the main PFI contract concerns only the project's "output" the sub-contracts are tailored to the specific task the member has to provide. In dividing the individual tasks between its members, the SPV awards in essence the specific works, supplies and services contracts. In a PFI contract for the provision of hospital facilities, these are the individual contracts concerned with building the hospital, supplying medical equipment and providing clinical facilities management.

The contractual relationship between the SPV and its shareholders resembles the

¹⁵ Arrowsmith (ed.), op.cit., note 24 of ch.2, p.398, para 9.207.

situation where a legal entity awards contracts for a publicly financed project to other legal entities. The aspect that PFIs are publicly financed could possibly trigger the application of procurement law. This would mean *inter alia* that intra-consortium contracts had to be advertised European-wide and the SPV had to conduct formal tendering procedures.

Conversely, bidding consortia are only established for the purpose to bid for the PFI and to place sub-contracts with its shareholders. If consortia had to publicly award intra-consortium contracts according to procurement law, their establishment was rendered economically impossible and meaningless.

The question arises whether the SPV is falling within the realm of the public or the utilities rules. If this question is answered in the affirmative, the intra-consortium contracts would have to “be awarded in full compliance with all the Directives’ provisions.”¹⁶

10.2.4.1. Public sector

Some SPVs may be included in the definition of works concessionaires and are thereby under a duty to comply with certain procedural rules spelled out in the Directives. If the SPV is held to be a public sector authority, it has to comply with the full regime of the Works and Services Directives. This obliges *inter alia* the SPV to award sub-contracts according to the procurement Regulations.

The three public sector Regulations contain a common definition of “contracting authorities.” These are the State, regional or local authorities and bodies governed by public law.¹⁷ Because the SPV is not a state authority listed in the Regulations, it may only be covered by the second leg of the definition. The term “bodies governed by public law” comprises entities, which are (1) set up for the specific purpose to meet needs in the general interest, (2) which are either wholly or mostly financed,

¹⁶ European Commission, *Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of Regions on Public-Private Partnerships in Trans-European Network Projects*, COM(97) 453 final of 10 September 1997, p.16.

¹⁷ Cf. Article 1(b) Supply, Works, Services Directive.

supervised or which board members are appointed by an authority and (3) which meet needs not having industrial or commercial character. The European Court of Justice emphasised in its *Mannesmann* decision that the three conditions must be cumulatively satisfied.¹⁸ The question arises whether the consortium may be considered as being “financed” by the contracting authority by means of the payments made under the project agreement.

In the *Cambridge University* case,¹⁹ the Court expanded on the concept of bodies governed by public law and held that “not all payments made by a contracting authority have the effect of creating or reinforcing a specific relationship of subordination or dependency. Only payments which go to finance or support the activities of the body concerned without any specific consideration therefore may be described as public financing.”²⁰

The Court further stressed with the Advocate General that the nature of the specific relationship must go beyond a normal commercial relationship formed by reciprocal contracts freely negotiated between the contracting parties.

The project agreement between SPV and contracting authority is a reciprocal contract not creating a relationship of subordination or dependency going beyond a mere commercial relationship. It is therefore advocated that SPVs do not come within the realm of the concept of “bodies governed by public law.” It can be concluded from the foregoing that the SPV is generally exempted from applying the public sector rules when awarding the intra-consortium contracts to its members.

10.2.4.2. Utilities sector

Despite the finding that intra-consortium contracts are exempted from the public sector Directives, they might come within the realm of the Utilities Directive. This is because the Utility Directive also covers privately owned entities which are “not

¹⁸ C-44/96 *Mannesmann Anlagenbau v. Strohal Rotationsdruck*, [1998] E.C.R. I-57, para 21 of the judgment.

¹⁹ C-380/98 *The Queen and H.M. Treasury, ex p. University of Cambridge*, judgment of 3 October 2000 (unreported).

²⁰ Para 21 of the judgment.

caught at all by the public sector rules.”²¹ The utility has to cumulatively satisfy two conditions. Firstly, the entity making the procurement must be a “relevant person,” either a public authority, a public undertaking or a body enjoying “special or exclusive rights.” Secondly, the Utilities Directive does only apply to “relevant activities” of the body which are expressly listed in the Directive.

In broad terms, the listed procurement activities encompass the areas of water, electricity, transport and telecommunications²² with exemptions for the upstream energy sector,²³ certain activities in the telecommunication market,²⁴ and the bus transport sector.²⁵

The U.K. Utilities Contracts Regulations take a moderately different approach from the EC regime. Schedule 1 to the Regulations provides an exhaustive list of “relevant persons” coming within scope of the rules in column 1 and explicitly specifies in column 2 the “relevant activity” which has to be procured pursuant to the Regulations.²⁶ A “catch-all” provision ensures that newly established or not listed entities are also caught by the U.K. rules. In respect to the regulated activities, there are no differences vis-à-vis the European Directive.

The question of whether SPVs are caught by the Utilities Directive is far from irrelevant as some SPVs delivered “relevant activities” to the public. In the transport area, the PFI scheme delivered various lightrail projects²⁷ and local governments outsourced the provision of water and sewerage services to PPPs.²⁸ Those activities

²¹ Arrowsmith, op.cit., note 2 of ch.1, p.382.

²² The Commission proposed in May 2000 to exempt entities operating in the telecommunications sectors from the ambit of the Utility Directive, European Commission, *Proposal for a Council Directive regulating the award of contract in the excluded sector*, section III “substantive amendments at para 2.2 et seq.

²³ Utilities Regulation 9.

²⁴ Utilities Regulation 7.

²⁵ Utilities Regulation 6 (h).

²⁶ Utilities Regulation 6(a).

²⁷ Dockland Light Railway-Lewisham Extension, Manchester Metrolink, Nottingham Lightrail.

²⁸ MOD Development in Sutton Coldfield, OJEC Notice of 07/07/98; Northern Ireland Office: Development of Public Private Partnership in the Water Industry including Bangor and Kinnegar Sewerage Projects.

are *per se* “relevant activities” for the purposes of Directive 93/38 and could bring a private sector SPV within its realm.

Hence, the SPV may have to award its intra-consortium contracts, if it is a “relevant person” for the purposes of the Utilities Directive and the U.K. Regulations. Both define relevant person as comprising public authorities, public undertakings or entities granted with special or exclusive rights. It has been established above that the SPV is not a public authority. Hence, the question arises whether the SPV comes within the realm of one of the two other categories.

The concept of “public undertaking,” includes bodies of an “industrial or commercial nature.”²⁹ This *per definitionem* necessitates that “one or more contracting authorities are able to directly or indirectly exercise a dominant influence by virtue of...”³⁰ one of the listed means of control. These are, for instance, the ownership of the public undertaking, a financial participation in it, a majority of shares or the right to appoint more than half of the managing personnel.

The condition of “financial participation” may catch a consortium, if the private sector undertakings have formed a joint venture with a public authority,³¹ the latter contributes existing assets or directly subsidises the asset development.³²

A good example for public sector financial contribution is the Docklands Light Railway extension to Lewisham with estimated capital cost (excluding financing charges) of £200 million. This figure includes private investment of approximately £165 million and public sector contributions from Her Majesty’s Government and the London Boroughs of Lewisham and Greenwich. The project’s sponsor and operator of the trains Docklands Light Railway Ltd. is additionally sponsored by the Secretary of State for the Environment by being a wholly owned subsidiary of the London Docklands Development Corporation (LDDC). Cash contributions from public funds

²⁹ Arrowsmith, op.cit., note 2 of ch.1, p.386.

³⁰ Utilities Regulation 3(2).

³¹ See above sections 2.2.3. and 2.3.1.2.

³² H.M. Treasury, Treasury Taskforce, op.cit., note 8 of ch.2, p.2.

in lightrail projects will be used to cover the difference between the expected revenue stream and the capital costs of the works. The authority contributing the funds could use its contribution to retain some influence over the delivery and management of the project. This aspect makes the subsidy different from an ordinary payment under a services contract.

One of the principles underlying all European procurement Directives is to avoid the risk of giving any preference to national tenderers or applicants whenever the contracting authority awards a contract.³³ As has been explained above for the public sector, it has to be examined on a case-by-case basis whether the financial contribution allows the authority to exercise at least indirectly dominant influence³⁴ over the consortium's economic activity. This can be denied in the overwhelming number of cases.

The SPV which was awarded a PFI contract could be brought within the realm of the Utilities rules by virtue of being granted a “special or exclusive right.” This is, pursuant to the definition of U.K. Regulations 3(2), “a right deriving from authorisations granted by a competent authority where the requirement for the authorisation has the effect of reserving for one or more persons the exploitation of an activity specified in the second column of Schedule 1.”³⁵ A contracting entity shall be especially “considered to enjoy special or exclusive rights where for the purposes of constructing the networks or the facilities, it may take advantage of a procedure for the expropriation or use of property or may place network equipment on, under or over the public highway.”³⁶

The question arises which criteria have to be satisfied to make rights “special” or

³³ C-44/96 *Mannesmann Anlagenbau v. Strohal Rotationsdruck*, [1998] E.C.R. I-57, para 33 of the judgment.

³⁴ C-353/96 *Commission v. Ireland*, judgment of 17 December 1998 (unreported) para 39 of the judgment.

³⁵ Utilities Directive Article 2(3).

³⁶ Utilities Directive Article 2(3)(a).

“exclusive”³⁷ for the purposes of the Utility Directive. Rights may be regarded as being “exclusive” when they are “reserved for or limited to a person or a group”³⁸ to the exclusion of other competitors.³⁹ In this situation the dependence on the state for continued approval and the insulation of the entity from the market justify the regulation of its purchases.⁴⁰

PFI contracts are not set aside for a specific group of tenderers. Hence, it is submitted that the concept of “exclusive rights” is not applicable. The remainder of the chapter will therefore focus on the concept of “special rights.”

Rights can be defined as “special” if they are only conferred to a particular group or person. If every person or entity can claim a right without meeting any conditions or by meeting certain minimum conditions, then the right cannot be referred to as “special.”⁴¹ On the first glance, a wide definition of “special rights” could possibly include SPVs which were awarded a PFI contract for designing, building, financing and operating a lightrail or a power station, such as an energy-from-waste plant. These projects are also likely to enjoy a special or exclusive right since the project company “may take advantage of a procedure for the use or expropriation of property” within the meaning of Utilities Regulation 3(2) in order to construct a network or facilities as listed in the Schedule. This could be for instance a network of lightrail tracks or a network of overhead power lines. Hence, SPVs operating one of the utilities activities fall at a first glance within the realm of the Regulations.

We have seen that if the Utilities Regulations became applicable, SPVs were obliged to comply with procurement law when placing its sub-contracts with the consortium members. It is questionable whether contracts awarded under a

³⁷ These are perceived by the ECJ to be separate concepts: Case 202/88 *Commission v. France* [1991] E.C.R. I-1223.

³⁸ *Oxford Advanced Learner's Dictionary* (1995), “exclusive.”

³⁹ Similarly: Arrowsmith, “Procurement in the Utilities Sectors and the Position of Private Companies” in: Abraham/Stuyck/Ballon (eds.) *Privatisations and Public Procurement in the European Union* (1998), p.104.

⁴⁰ European Commission, *Proposal for a Council Directive regulating the award of contract in the excluded sector*, para 14.

⁴¹ Case 13/77, *Inno v ATAB* [1977] E.C.R. 2115.

competitive procedure can be caught by this interpretation of “special rights.”

There are five arguments suggesting that SPVs might not come within the realm of the Utilities Directive.

The first argument against bringing SPVs within the realm of the Utilities Directive is of economic nature. On a micro-economic level, it can be held that excluding intra-consortium contracts from applying the procurement Directives is an economically reasonable solution. The shareholders of the SPV established the “man of straw” merely for the purpose of co-ordinating their activities regarding the PFI project. By obliging joint ventures to award their intra-group contracts according to the procurement rules, one would render such highly efficient co-operations⁴² impossible.

On a macro-economic level, it can be inferred from Commission Communications in the areas of public procurement⁴³ and Trans-European Transport Networks⁴⁴ that the Commission regards Public-private partnerships and other concession agreements as being of “economic significance”⁴⁵ “and of “great interest for the Single Market.” In particular, the formation of special project vehicles is highly recommended to ensure a “stable framework within which the various partners can establish a confident working relationship.”⁴⁶ The formation of SPVs help to deliver cross-border projects, as for instance the Channel Tunnel, and are therefore consistent with the aims and purposes of the Treaty and the procurement Directives. The Commission concludes that any “remaining barriers to their creation should be removed.”⁴⁷ Requiring SPVs to award the contracts to their shareholders in accordance with the Directives would impose a significant barrier to the creation of an effective special project vehicle. From a micro- and macro economic perspective it is

⁴² For the “partnering” approach: Cox, Townsend, *Strategic Procurement in Construction*.

⁴³ European Commission, op.cit., note 113 of ch.3.

⁴⁴ European Commission, op.cit., note 16.

⁴⁵ European Commission, op.cit., note 113 of ch.3.

⁴⁶ European Commission, op.cit., note 16, p.10.

⁴⁷ European Commission, op.cit., note 16, p.14.

arguable to exempt SPVs from the realm of the Directive.

The second argument supporting the exclusion of competitively awarded contracts is that these have been initially awarded in accordance with objective, proportional and non-discriminatory criteria as laid down in the procurement Directives. It can be assumed that the exercise of market forces have made such contracts significantly less susceptible to government influence. In addition, they are not reserved for a particular group of persons and, therefore, are not “special.”

It is possible to argue against this view that objective criteria, as for instance “technical capacity” involve the exercise of subjective discretion and, hence, the potential for discriminatory State influence.⁴⁸ This view is underpinned by the fact that the private entity granted with a “special” right is subject to state influence because it vitally depends on the state's continuing approval, for example, to carry on its activity under a concession.⁴⁹ Conversely, the exercise of “subjective discretion” and the dependence on the continuing governmental approval is to a varying degree inherent to every government contract and does not *per se* justify the characterisation as “special.”

Placing the “special or exclusive rights” alternative in its regulatory context calls forth a qualitative comparison with the other group of entities covered, these are “public undertakings” and “public authorities.” The first common element inferable from the comparison of the other alternatives is the exceptional exposure to state influence. As in the case of “public undertakings,” the reason to regulate the purchases of public or private entities is the possibility of state influence that may induce “uneconomic”⁵⁰ and discriminatory procurement practices. Consequently, the “special or exclusive rights” conferred to an undertaking must imply a degree of dependence on the state, making this concept comparable with “public undertakings” and “public

⁴⁸ Arrowsmith, *op.cit.*, note 2 of ch.1, p. 102.

⁴⁹ European Commission, *op.cit.*, note 40, para 13.

⁵⁰ *Ibid.*, para 14.

authorities.” Dependence on the state can be assumed if the conditions laid down in the twelfth recital of the preamble of Directive 93/38 are satisfied. This includes cases where state authorities participate in the capital of the entity or are represented in the entities administrative, managerial or supervisory bodies.

Both other alternatives, “public authority” and “public undertaking,” have a second aspect in common, namely the insulation of the entity from the market. The insulation results in both cases from barriers to entry for potential competitors. The Commission assumes that in situations where a private or public entity is sufficiently insulated from market forces, it can pursue other goals than securing the economically most viable offer. The protection of national suppliers and contractors is identified as one of the non-economic goals.⁵¹

It is submitted that both conditions, insulation from the market and exposure to substantial government pressure must be existent to a significant degree to bring an entity awarded with a “special” right within the realm of the Directive. It appears doubtful whether competitively awarded contracts, such as contracts regarding a PFI project, subject the awarded entity to governmental pressures and insulates it from the market. Additionally, the uncertainty in relation to the required degree of “market isolation” and “government influence” renders it impossible to base a reliable statement when the “special rights” concept will be satisfied in the PFI context.

A third argument for releasing PFI contractors from the Utilities Regulation may be gained from a comparison with in-house agreements. It is suggested in respect of the award of in-house contracts that where the work, the supply of goods or the service is awarded to an in-house service provider which is legally part of the purchasing authority, there is in law no contract.⁵² This means that in-house contracts may be awarded without following the procedures of the procurement rules. Nevertheless, the “in-house exemption” requires that the in-house provider is legally part of the

⁵¹ *Ibid.*, para 10.

⁵² Arrowsmith, *op.cit.*, note 2 of ch.1, p.118.

purchasing organisation and there will not come any contract into existence between the both parties involved.⁵³

The scenario of in-house contracts bears resemblance with the legal and factual relationship between the SPV and its shareholders. However, the purchasing entity in the case of a PFI project is part of the shareholders' portfolios rather than *vice versa*. Notwithstanding, both situations share a substantial relationship between the purchasing entity and its suppliers which goes beyond the single works, supply or service contract. In both situations, the parties have specified from the outset the entity supplying goods or providing services. In the in-house situation, the purchasing authority decides to source the service or good in question from an in-house provider instead of seeking external offers. Under the circumstances of an intra-consortium contract, it is the sole purpose of the consortium to award the project's main sub-contracts among its shareholders.

Conversely, it can be argued against comparing in-house with intra-consortium contracts that the SPV and its shareholders are separate legal entities. This feature clearly distinguishes both situations. Another distinct characteristic of intra-consortium contracts is that they are legally formal agreements between SPV and the respective shareholder. In order to avoid the application of the procurement regime, the legally separate parties had to enter into an informal and non-contractual supply or service agreement.⁵⁴

However, such a practice would not be in concordance with the procurement guidance provided by the Treasury and would due the created legal uncertainties not be supported by the project lenders. Those guidance notes pre-suppose *inter alia* that the contracting agency awarding the PFI contract must be "satisfied with the

⁵³ Kunzlik, "Intra-group transactions under the Utilities Procurement Directive," (1993) *Utilities Law Review*, p.211.

⁵⁴ Arrowsmith, *op.cit.*, note 2 of ch.1, p.414.

background contractual arrangements, such as the sub-contracts to be put in place.”⁵⁵

It can be submitted for reasons of accountability⁵⁶ of the sub-contractor for its respective stake of the project that the public entity has a prime interest of ensuring that the contracts between the SPV and the sub-contractors are legally binding formal arrangements. Hence, the exemption for in-house contracts is not applicable to intra-consortium contracts and SPVs cannot be released on this ground from applying the utilities rules.

The fourth argument is that the authority concludes implied contracts with the SPV’s shareholders. In fact, the contracting authority expressly considers the contractual relationships and the capability of the shareholders when assessing the expertise and financial standing of the SPV. This indicates that sub-contracts are simultaneously awarded together with the project agreement. Thereby, the authority implicitly concludes the PFI contract with the shareholders of the SPV.

In addition, shareholders are bound by the project agreement via their shares in the SPV and the performance guarantees. Those guarantees are a core interest of the public authority, since the SPV may lack the technical and financial means to perform the contract. From this perspective, it appears possible to consider the SPV and its shareholders as one entity. The award of sub-contracts would then be more comparable to the situation where works, the supply of goods or services are awarded to in-house providers. Consequently it can be argued to release SPVs from the Directive’s realm.

The fifth argument suggested against bringing SPVs within the ambit of the Utility rules is that the utility is not yet a “relevant person” at the time when it places the intra-consortium contracts with its shareholders.

Before the examination of this argument, it seems useful to clarify the different

⁵⁵ H.M. Treasury Taskforce, *Case Study on the first eight DBFO road contracts and their development*, Chapter 4, “The process”.

⁵⁶ Ministry of Defence, op.cit., note 47 of ch.2, para 6.1.

stages involved in the bidding process from the contractor's perspective. In employing the example of a lightrail project, interested firms vested with different skills join together to form a bidding consortium. The consortium interested to deliver “lightrail services” to the public may encompass a construction company, an operator and one or more financiers.⁵⁷ The construction company and the operator will expect to enter into the construction contract, the operation and the maintenance contract respectively.⁵⁸ In the early stages of the bidding process, the firms will, as a natural part of the consortium's creation, place the prospective contracts among them, even if this does not happen by formally concluding the contracts. At this point in time, the consortium is obviously not a utility for the purposes of the Directive, since it either has no legal form or at least does not have the right to perform one of the “relevant activities.” Even if the sub-contracts are awarded in a formally legal manner, the “unborn utility” does not have to award its sub-contracts.

Before the actual award of the contract, the consortium is likely to be chosen as “preferred bidder.” It is in this stage of the award process that the contracting authority will, in conformity with H.M. Treasury guidance notes,⁵⁹ insist that the joint venture of companies establishes a SPV vested with legal personality to negotiate and conclude the PFI project agreement. If possible, consortium members should “award” the actual sub-contracts among them as part of the process leading to the conclusion of the main PFI contract. Until this point in time, the SPV is not a utility, and the award of the intra-consortium contract can be done without having recourse to procurement law.

This situation arguably changes after the award of the project agreement, vesting the SPV with its “special or exclusive right” to provide, for example, lightrail services to the public. Subsequent to the award of the contract the SPV becomes a “relevant

⁵⁷ H.M. Treasury, Treasury Taskforce, op.cit., note 13 of ch.2, stage 11: The project’s funder should get involved as early as possible to avoid unnecessary delay .

⁵⁸ Vinter, op.cit., note 193 of ch.2, p.235.

⁵⁹ Central Unit of Purchasing, *Guidance 51- Introduction to the EC Procurement Rules*, para 2.12.

person” for the purposes of the Directive.

It is questionable whether the SPV exercises at this point in time a “relevant activity” within the meaning of the Utilities Directive. It is argued that the Utilities Directive does not apply to a project company during the construction of the network, because at this stage of the project, the SPV has not yet engaged in any utility activity.

One could argue from the rules wording that the project company does not yet *have* or actually *carried on* a specified utilities activity and therefore it is not within the realm of the Regulations during its construction phase.⁶⁰ The operator of a lightrail is not yet operating “networks providing a service to the public in the field of transport by... tramway” within the meaning of Article 2 of the Directive. The entity only concludes agreements in order to construct the asset and prepare the operation of the lightrail.

The Utilities Regulations does not explicitly mention the case of “ghost utilities”⁶¹ but it defines a utility as entity which “carry on” or “has as one of its activities”⁶² one of the specified utilities activities. With reference to those provisions, it has been argued that the SPV is exempted from the utility regime as long as it has not obtained the rolling stock and has commenced operations. In the context of consortia, the above argument is especially attractive due to its practical consequences. The SPV awarded with a PFI contract would not be obliged to put its, construction, operation and maintenance agreement out to tender.

The better argument rejects this overly literal reading which exempts the most important⁶³ and certainly economically most significant agreements in the life of the utility. Instead of focusing on the wording of the Directive, it appears more appropriate to have recourse to the more substantive aims and purposes of procurement law. It is submitted that the Utilities Directive aims to include entities

⁶⁰ Vinter, op.cit., note 193 of ch.2, p.235.

⁶¹ Arrowsmith, op.cit., note 2 of ch.1, p.413.

⁶² Utilities Regulation 3(2).

⁶³ Arrowsmith, op.cit., note 2 of ch.1, p.413.

which were granted with the special or exclusive right to carry on a relevant activity. This goes irrespective of whether the entity carries on that activity at the time in question.

The adoption of a functional approach identifies the powers and rights of the entity as more important than the activity it is currently performing. Viewed from this perspective it is more important that an authority empowered the SPV to develop and operate a lightrail system than the fact that it has not commenced operation yet. Arguably, the conferral of the rights to operate the relevant activity empowers the grantee to pursue discriminatory procurement practices. This justifies to regulate its procurements. Moreover, the project agreement includes the development and the operation of the lightrail. It appears unjustified to artificially separate both stages and to conclude that the SPV becomes a utility only on the first day of its operation. The “provision” of a transport network does include both stages with the development of the network as a necessary prerequisite of the operation.

It is therefore submitted that subsequent to the conclusion of the contract and the conferral of the “special or exclusive right,” the SPV becomes a “relevant person,” which has to comply with the utility rules when awarding its contracts. In the context of PFI projects, the private SPV may be brought within the realm of the Utilities Directive by virtue of operating in a non-competitive market situation. These findings entail that the procurement rules may be applicable to intra-consortium contracts.

As a result of the five arguments one may conclude that the legal situation is one of uncertainty. There may be good argument in favour of releasing SPVs from the realm of the utilities rules, however, a wide approach to interpreting the “special rights” concept suggests that SPVs carrying on “relevant activities” come *prima facie* within the scope of the rules.

It has to be noted that the Commission did not show and currently still does not show any intention to pursue cases where a SPV places sub-contracts among its shareholders. This assessment of the risks to be challenged is based on mere empirical

evidence and, hence, cannot guarantee that the Commission maintains this attitude in the future. The Commission has to address the remaining uncertainties when reviewing Directive 93/38. The complicated situation of the law would have been substantially eased, if the proposed Article 4 had been implemented, which largely exempted contracts between concessionaires and associated or affiliated undertakings (shareholders).⁶⁴ The reasons for dropping this useful provision in the course of the legislative process are not comprehensible.

10.3. Empirical findings

In the context of how to treat consortia under procurement law, the interviews with legal advisors focussed on the pertinent issues, namely changes in the composition of consortia and the uncertainties surrounding the award of intra-consortium contracts.

10.3.1. Changes to consortia

Many lawyers, such as BothSA#2, BothSA#4 and BothSA#6, put forward that the loose cohesiveness of consortia was a basic and very common problem in the PFI procurement process. They all gave examples of projects where the composition of the bidding consortia changed substantially. Consortium members regularly dropped out or were replaced by other companies. BothSA#3 said

“in many projects, the people who are bidding for the contracts have nothing to do with those who end up being the actual contractors; there is no connection between them whatsoever. You see more changes to the consortium than to the project itself.”

PubSA#4 remarked this practice raised the difficult procedural issue of how to assess the changed consortia. BothSA#5 said he gave the advice to go back in the procurement process to examine whether the consortium in its new composition still

⁶⁴ European Commission, *Amended Proposal for a Council Directive on the procurement procedures of entities operating in the water, energy, transport and telecommunications sectors*, COM (89) 380 final, pp. 31-32.

had been qualified, shortlisted and brought forward to the current procedural stage. He acknowledged that this “going back” procedure was far from straight forward in practice. Public sector clients had difficulties in determining the current procedural stage of their project.

PubSA#4 said in order to avoid the occurrence of having to deal with one important member of the consortium dropping out, authorities started to examine the track record of companies and consortia in other partnering relationships or PFI arrangements. Authorities were particularly interested whether the consortium members previously worked successfully together and were committed to the cohesion of their joint-venture.

In addition to imposing this criterion on tenderers, PubSA#3 mentioned that “big players in the field now know who they can work with.” It can be concluded that private sector firms were equally interested to ensure that the process of re-structuring consortia did not unnecessarily delay the procurement process.

10.3.2. Intra-consortium contracts

Only a relatively small number of lawyers had experience with PFI projects involving the delivery of utility infrastructure, such as light-rail schemes and energy from waste facilities. Only in those projects it is likely that the SPV may be obliged to award its intra-consortium contracts according to procurement law. BothSA#1 and PubSA#9 who had experienced utility PFIs uncompromisingly refused to discuss the issues of intra-consortium contracts. This exceptional reaction allows the conclusion that the issues at stake are of highly “sensitive nature.” What is more, legal advisors appeared to be very well aware of the potential risks involved in not advertising intra-consortium contracts.

In employing the first arguments for SPVs not coming within the realm of the utilities rules, BothSA#1 perceived it as absurd that the SPV had to advertise the sub-contracts to its shareholders who established the SPV for this very reason. He added that

“we have not found a way around the application of the procurement rules, but applying them in this situation would make PFIs unworkable.”⁶⁵

It can be inferred from this statement that the utility rules were widely ignored and sub-contracts were not advertised.⁶⁶ PrivSA#6 mentioned that in projects where the intra-consortium contracts had been advertised

“there is a remarkably high coincidence between the identity of the developers and the contractors, so that in each deal the developer/contractor seems to end up winning the contracts even though it had been advertised.”⁶⁷

The risk for the SPV of being challenged on not advertising intra-consortium contracts was, as maintained by PrivSA#6, especially low. This was mainly because the remedies were available to the very people who formed themselves SPVs and probably were in breach of the same Regulations elsewhere. BothSA#1 said advertising the contract was only sensible for some project developers, but not in the normal situation where shareholders set up a joint venture to bid for a PFI.⁶⁸

BothSA#1 challenged the proposition that SPVs had to advertise their intra-consortium contracts at all in using the fifth argument developed above in section 10.2.4.2. He said that the intra-consortium contracts were allocated at a time when the consortium did not know whether it had won the contract to become a utility for the purposes of the Directive.⁶⁹ He concluded that “ghost utilities” arguably fell outside the ambit of the Utility Directive.

PrivSA#3 and BothSA#3 held on similar considerations that the utility rules were not applicable. In the case of a light rail project, the SPV was not yet “operating” a

⁶⁵ BothSA#1.

⁶⁶ PrivSA#6.

⁶⁷ PrivSA#6.

⁶⁸ BothSA#1.

⁶⁹ BothSA#1.

transport activity, as it was as required by the Directive. In building the rail tracks and purchasing the rolling stock, the SPV only adopted preliminary measures to become operating. As a result of employing the fourth argument for releasing SPVs from the utilities rules, they concluded the works concession regime was more suitable to deal with such infrastructure projects.⁷⁰

In using the third argument, PrivSA#6 advocated the shareholders of the SPV should be viewed as a part of the winning consortium and, hence, the sub-contracts were not genuine third party contracts.⁷¹ He supported his opinion with the argument that the procurement was essentially done in one piece and, therefore, an analogy should be drawn with the “affiliated undertaking” rule in the works concessions regime. Moreover, the policy objective of procurement was to ensure competition and value for money. Part of the latter was to transfer as many risks to the private sector as possible. Having both an equity interest and a contracting interest in the project enabled the shareholder to draw more overall risk than an external contractor. The former had more knowledge about the project and had the opportunity to optimise the risk transfer.⁷²

On a practical level, the SPV was letting a whole host of sub-contracts and insofar as they were not taken up by the shareholders they might well be advertised. He suggested to advertise all sub-contracts and to deal with the problem by scoping the individual work packages in a way that the shareholders became effectively bidders. However, project lenders were not prepared to accept the additional risk that the SPV is exposed to any third parties claim which was not accounted for in the financial model for the SPV.⁷³ Those claims could arise from tendering intra-consortium contracts in a formal award procedure according to procurement law.

Despite the relative infrequency of the problem, lawyers were aware that SPVs

⁷⁰ PrivSA#3; BothSA#3.

⁷¹ PrivSA#6.

⁷² PrivSA#5.

⁷³ PrivSA#6.

delivering PFIs in the utility sector may have to advertise their intra-consortium contracts according to procurement law. The quote of BothSA#1 he had not found a convincing way around the rules reflects a general attitude that the better arguments were supporting the conclusion that the utility rules were applicable. All respondents with experience in utility areas drew the attention to the great deal of uncertainty surrounding this issue. This uncertainty led to the adoption of the approach most beneficial to the private sector client. BothSA#4 said:

“no private sector client would consider advertising its sub-contracts meant to be allocated with the SPV's shareholders or the company's departments.”

Lawyers and their private sector clients adopted this law-defying approach because the risk of sanctions was perceived as theoretical,⁷⁴ because

“the remedies are available to the very people who would themselves form SPVs and probably would be elsewhere in breach of the Regs.”

Therefore, when SPVs balanced the pros and cons of adopting a compliant approach, they had to reach the conclusion that the benefits of non-compliance clearly surpass the benefits of compliance. Strict compliance with the law would hinder the swift implementation of the schemes and sub-contracts would be effectively awarded twice. This perception reflects the low impact procurement law has had on the PFI procurement practice regarding intra-consortium contracts.

On a policy level, the problem of whether to award intra-consortia contracts reflects the failure of the European legislator to provide suffice legislative or interpretative guidance. This issue may overarch all procurement problems discussed in the study and we shall therefore return to it in chapter 12.

⁷⁴ PrivSA#5.

Chapter 11 Step-in rights

11.1. Introduction

The EU procurement rules are primarily concerned with the stages leading to the award of the contract, whilst the European legislator disregarded the post-award phase of public projects. However, this important phase in the life of a PFI project, which easily lasts 25 years, may render decisions necessary which bear resemblance to a procurement process. For instance, project lenders may choose to replace a sub-contractor in the operation phase which fails to deliver services up to the agreed standards and thereby threatens the success of the project. When effectively re-awarding the sub-contract, the question arises whether the financiers have to comply with the public procurement rules.

11.2. Step-in rights – the legal problems

11.2.1. Step-in rights

With the exception of projects in the IT sector, PFI projects are financed by various sources of finance, consisting generally of a mix of equity and debt.¹ Equity providers, such as the shareholders and investors in the SPV, typically contribute not more than 8-15% of the capital cost. The equity share covers certain types of risks with which the debt providers are not comfortable with, such as the risk of demand.² Hence, debt providers cover the most substantial part of the capital costs, amounting to a share of 85% to 95%. Debt for PFI projects is provided by banks, a syndicate of debt funders acting through their agent bank or project lenders and may also be raised through the bond market.³

Debt providers have a fundamental interest to secure their investment in a PFI project. The SPV delivering the PFI project is a mere shell company and can offer

¹ Lindrup/Godfrey (ed.), op.cit., note 1 of ch.1, “Financing”; Morrison/Owen, op.cit., note 71 of ch.2, ch.6.

² Lindrup/Godfrey, op.cit., note 1 of ch.1, “Financing” para 44.

³ H.M. Treasury, *CUP Guidance No. 48 Bonds and Guarantees* (1994); Matheou, “Future financing: the developing market for project capital” (2000) *PFI Intelligence Bulletin* (October); “PFI: Novel bond behind hospital,” *Financial Times* May 21, 1999.

only a few securities to its lenders. The principal assets available as security are the rights of the SPV under the project agreement with the awarding authority. In cases where the authority pays for the services delivered under the project agreement this includes the income stream the SPV receives from the authority. The security package of rights and controls is therefore designed in such a way as to provide the project banks access to the income stream.⁴

The income stream and consequently the main security of the debt providers may come under threat where a right for the authority arises to terminate the project agreement which could ultimately result in the authority ceasing to pay the SPV for the service delivery.

The project lenders therefore require direct agreements with the authority and the major sub-contractors. The direct agreement includes the right to prior warning of an intention of a party to terminate and enable the bank to choose whether to step in the respective sub-contract. The financiers subsequently take over the contract of the failing sub-contractor with the aim to negotiate a transfer of the contract to another operator. This routine enables the service to continue without disruption and secures the income stream of the SPV against a precipitous termination of a project contract. For example, if in a hospital project the sub-contractor operating the asset fails to deliver services to the required standards, the authority may warn the project lender that it contemplates to terminate the project agreement. The project lenders will then take over the contract for a limited period until they have appointed an appropriate facility management company to replace the failing sub-contractor.

From the perspective of the public authority, it is pivotal under those circumstances to safeguard its interests by including a veto right in the direct agreement. The veto right ensures that the project lenders do not assign any part of the

⁴ Morrison/Owen, op.cit., note 71 of ch.2, p.61.

contract to a third party without public sector agreement.⁵ The grounds for exercising this veto right should be focused on objective categories or should prescribe a list for unacceptable transferees rather than adopting the approach of a general veto right.⁶ Granting the authority a general right to reject candidates proposed by the banks is likely to prolong negotiations and to extend the costly time of disruption.

11.2.2. Step-in rights and procurement rules

Subsequent to the exercise of its step-in right, the financiers replaces the failing contractor in “awarding” the project agreement, or the respective sub-contract to another entity. This replacement process raises the question of whether the selection of a new contractor or sub-contractor needs to be made in accordance to the procurement rules.

On a practical level, this raises the further question of how to draft direct agreements so that the procurement rules do not apply when project funders execute their step-in rights. This issue may be considered as a typical legal uncertainty in PFI procurement. Despite the obvious importance of the questions involved for project funders, the procurement rules do not contain any specific provisions and there is no guidance from either the Court or the European Commission.

11.2.2.1. Replacement of sub-contractor

The exercise of step-in rights is most likely to occur in a situation where a sub-contractor has failed to perform its contractual duties up to the agreed standards. This may eventually give rise to a right to terminate the project agreement for the authority. In this situation, the project agreement is likely to remain unaffected and the project lenders only substitute the respective sub-contractor. After the substitution of the failing sub-contractor, the authority novates the rights and obligations of the failing

⁵ H.M. Treasury, op.cit., note 4 of ch.2, para 6.32.

⁶ H.M. Treasury, Treasury Taskforce, *Guidance on Project Agreements: Consultation Draft*, XVI.B.2.c.

sub-contractor to the substitute proposed by the banks.⁷

The direct agreement grants the authority with the right to veto incoming substitutes for failing sub-contractors. The practice may have the side effect to trigger the procurement rules. Exercising its veto right gives the authority the opportunity to impose restrictions on incoming sub-contractors. There are three approaches to address this issue.

A first view, advocated by the H.M. Treasury, perceives the replacement of sub-contractors as a mere “reorganisation within the group providing the public sector with a service.”⁸ This view is based on the assumption that the project lenders are part of the bidding consortium. Hence, the procurement rules are not applicable, if the contractual rights and obligations are otherwise unchanged. The public sector authority should have a right to veto and should be allowed to take wider considerations into account, such as political considerations, national security, and other “public interests.”⁹ The Treasury gives the example of replacing an operating company failing to deliver the adequate school services by a tobacco company.¹⁰ From a public policy viewpoint, this was held to be unacceptable.

The second option for interpretation is that by granting legal control to the authority over the replacement of the failing sub-contractor, the procurement procedures of the Directives must be adhered to. In imposing restrictions on the incoming sub-contractor, the authority could effectively influence the choice of the project lenders in a discriminatory manner. As any discriminatory practices contravene the purpose of the Directives, their rules may be fully applicable when replacing sub-contractors after exercising step-in rights. However, applying the

⁷ “Novation” means an agreement by which all the parties to a contract agree that a third party is to stand in the place of one of the original parties. This is, strictly speaking, not a transfer of the original contract but the extinction of the original contract and the creation of a new one.

⁸ H.M. Treasury, *Private Opportunity Public Benefit*, para 6.16.

⁹ H.M. Treasury Taskforce, *Taskforce Standardisation Document for final consultation* (1999), 17.4.1.

¹⁰ *Ibid.*

procurement rules to any replacement of sub-contractors seems unjustified as there is no “new contract” coming into existence for the purposes of the Directives. In the situation of a mere replacement, procurement law has been adhered to before when awarding the project agreement. The “reorganisation within the group providing the public sector with a service”¹¹ does not have to trigger the rules for a second time, because the principles underlying the Directives, such as non-discrimination, equal treatment and competition, are not put at risk.

Arrowsmith submits that adopting such an extreme view is disproportionate and as such unnecessary to give effect to the aims and purposes of procurement law.¹² She argues that if the veto right of the authority is limited to the objective criteria contemplated in the Directives, “a veto is permitted without the need for advertisement etc. ...”¹³ Hence, authorities could reject incoming substitutes on the grounds of the qualification requirements, such as financial standing, technical capability and the legal conditions laid down in Regulation 14 without triggering the procurement Directives. Arguably, this allows authorities to consider national security and the qualification criteria of the Directives, but not, as the Treasury promotes, to reject a tobacco company from running a school or a hospital on policy reasons.

The restriction of veto grounds to the Regulation 14 conditions ensures that authorities do not circumvent the rules of qualification by interposing a body between the authority and the firms performing the works and services and introducing more restrictive criteria for their selection than permissible under the Directives.¹⁴

It can be summarised that it is uncertain whether in a step-in situation the procurement rules are triggered.

11.2.2.2. Replacement of SPV

A right to terminate may also arise where the SPV fails to deliver services up to

¹¹ H.M. Treasury, op.cit., note 8, para 6.16.

¹² Arrowsmith (ed.), op.cit., note 24 of ch.2, para 8.065.

¹³ *Ibid.*

¹⁴ *Ibid.*, para 8.064.

the standards agreed in the project agreement. If the banks decide to step in, they have the delicate task to replace the SPV which is the contractor to the project agreement. It is submitted that a novation of the rights and obligations of the SPV is permissible under the same conditions as developed for sub-contractors.¹⁵

11.2.2.3. Changes to the contract terms

The deliberations have been based so far on the presumption that the contractual agreements, these are either the project agreement or the sub-contract, remain unchanged. The mere substitution of the SPV or a sub-contractor with a new entity is not the most likely scenario because the contractual terms may have been one reason why the departing contractor has failed. For instance, the terms of the respective contract may have been too onerous for reasons of unsound risk allocation.

In addition, the incoming contractor may bring forward innovative ideas regarding the delivery of the respective services or just seeks to re-negotiate the agreement in its favour. This especially applies in circumstances where services are added subsequent to re-negotiating the agreement.

Where the contractual parties consider changing the contractual arrangement substantially, concerns may arise over whether the changed contract may be considered a “new contract” for the purposes of the procurement rules.¹⁶ Changes to the contract are defined as substantial if the new work exceeds 50% of the amount of the original tender¹⁷ or if they are material to an extent that different firms might have been interested in the contract.¹⁸ Where substantial changes occur and the “economic balance” of the contract is changed,¹⁹ the contract must be re-advertised as a “new contract” in accordance with the procurement rules.

¹⁵ *Ibid.*, para 8.067.

¹⁶ Arrowsmith, op.cit., note 2 of ch.1, p. 123.

¹⁷ Deduced from Article 7 (3)(d) Works Directive.

¹⁸ *R. v. Portsmouth City Council, ex parte Peter Coles and Colwick Builders*, Court of Appeal, judgment of November 8 1996; Auricchio, “The Problem of Discrimination and Anti-Competitive Behaviour in the Execution Phase of Public Contracts,” (1998) *P.P.L.R.*, p.128.

¹⁹ Arrowsmith (ed.), op.cit., note 24 of ch.2, para 8.073.

11.3. Empirical findings

Respondents had experience in drafting step-in rights for project lenders included in direct agreements. However, none of interviewees experienced situations in PFI where project lender exercised their step-in rights. Only PrivSA#5 mentioned a project where their exercise was contemplated but did not occur in the end. Therefore, legal advisors interviewed found the question difficult to answer, because they had not spent much thought on the potential implications arising from procurement law.²⁰ Some respondents, such as PubSA#4 and PubSA#7 doubted whether the procurement rules were applicable in this situation.

11.3.1. Veto grounds

Not many respondents could recall the veto grounds previously used in PFIs. PubSA#4 remarked the specific veto grounds were more a banking lawyers issue and she did not become involved in drafting those rights. BothSA#1 remarked the question of which step-in rights to include into the direct agreement was dealt with project specifically, although they became increasingly standardised.²¹ Every lawyer who could remember specific step-in rights mentioned that they resembled the qualification criteria in the Regulations. BothSA#2, PubSA#6 and PubSA#10 maintained that it was permissible for the authority to request technical, financial and legal information from the candidate chosen by the project lenders.

PubSA#6 remarked to apply the criteria laid down in the procurement Directives meant to give the basic suitability test the necessary objectivity. She thereby agreed with the third option for interpretation submitted by Arrowsmith that the grounds contained in the Directives warrant that the authority becomes involved in the replacement process only to a limited extent. PrivSA#6 mentioned that authorities frequently sought to include reputational criteria. He gave the example of a health trust

²⁰ PubSA#10; PubSA#4.

²¹ PubSA#2.

that certainly did not want a tobacco company to step into a hospital contract. He described those reputational criteria as sector specific.²²

PrivSA#1 reported that in PFI project related to defence, the criterion of national security and secrecy was included in the direct agreement.²³ In general, the criteria to be included were subject of commercial negotiations which were usually “won,” as PrivSA#5 maintained, by the project lenders. It is possible to conclude from the responses given that the existing veto grounds were reconcilable with the qualification grounds contemplated by the Directives.

Lawyers were unequivocal about the principles underlying the restriction of the veto rights. PubSA#2 mentioned that because the banks guaranteed for the performance during the step-in period, they had a significant economic incentive that the substitute was capable to perform up to the required standards.²⁴ She added that as long as the project lenders provided the authority with the limited information they were allowed to require, it had no rights of veto. She said by analogy, some of the soft facility management services were subject to 5-7 yearly market testing. This was not a process conducted by the authority but by the contractual partners.

BothSA#3 similarly concluded the public sector should not interfere with the process of substituting sub-contractors at all. He thereby supported the Treasury’s interpretation. It is for those reasons, that legal advisors were keen to have very narrow rights of veto, although the adoption of this rather “passive role”²⁵ might be difficult to explain to their public sector clients.²⁶ BothSA#3 said the theory was that under the PFI project agreement it was all about setting the right services standards and the sub-contractor was financially penalised if it failed to meet those standards. This principle applied irrespective of who was responsible for delivering the service.

²² PrivSA#6.

²³ PrivSA#1.

²⁴ PubSA#2.

²⁵ BothSA#3.

²⁶ PubSA#2.

PrivSA#6 said project lenders sought to restrict the veto rights to technical and financial considerations.²⁷ The main concern of lenders was the security of the income stream. Provided that the revenue stream was flowing and the debt service was met, the banks wanted as much flexibility as possible. From his experience, the lenders had the upper hand when it came to negotiating the veto rights of the authority.²⁸

11.3.2. Step-in right as last resort

BothSA#3 said a common understanding existed in the market that the exercise of step-in rights was a worst case scenario. The funders preferred to rely rather on other security mechanisms before contemplating this option.²⁹ For instance, even in a major international infrastructure project where many problems occurred, the exercise of step-in rights was seen as a very last resort.³⁰ This was partly due to the impression that the authority was probably better off to stick with the contractors they got rather than bringing somebody else in.

BothSA#2 suspected for this reason it was probably more likely that refinancing proposals were favoured and the exercise of step-in rights was contemplated only in serious situations such as insolvency. PubSA#6 added this was particularly true in complicated IT project, where the banks lacked the expertise to get involved and choose an appropriate candidate. PubSA#6 said that the banks she had spoken to would not get engaged in IT contracts except in the most unusual circumstances.³¹

11.3.3. Are the procurement rules applicable?

Once the step-in rights were exercised and the contract was substantially altered, it was suggested to the respondents that the procurement rules became applicable. PubSA#7 shared the view of the Treasury when arguing against this assumption. She said that the bank was a member of the consortium with the effect that the (sub-) contract did not have to be advertised under the rules. The financiers were part of the

²⁷ PrivSA#6.

²⁸ PrivSA#6.

²⁹ BothSA#3.

³⁰ BothSA#2.

³¹ PubSA#6.

qualification and award process and if they stepped in that had been always been contemplated by the process that was carried on.³²

PrivSA#6 remarked the incoming contractor stepped only in a project which itself had been subjected to the rules. By substituting one entity by another, it was not required to re-enter the arena and to ensure a fair bidding process according to the objectives of the procurement rules.³³ PrivSA#6 argued that a major aim of the rules was to promote competition and a level playing field where bidders got the opportunity to put their best bid forward. The competition requirement was satisfied by the initial competitive bidding procedure.

The contrary argument, which he personally supported, was that if the consortium owned an asset and if it sought somebody to benefit from that asset then probably everybody should be afforded the opportunity to take it although the terms had been pre-determined.³⁴ Hence, from a legality perspective the contract ought to be offered, from the perspective of the lenders it was obvious why the existing contractual parties wanted to retain control.³⁵

11.3.4. Findings

Although lawyers disregarded the possible procurement issues widely, they granted the authority only restrictive veto grounds as proposed in the academic literature. This was thought to strike an appropriate balance between the interests of the parties to the project agreement and the financiers. As in other problem areas, respondents felt that the risk of being challenged on not advertising the “new contract” was comparatively low due to reasons related to the remedies system.

PubSA#4 mentioned that any changes to the consortium probably occurred without much publication thereby significantly reducing the risk of being challenged

³² PubSA#7.

³³ PrivSA#6.

³⁴ PrivSA#6.

³⁵ PrivSA#6.

on the decision.³⁶ She added it was very difficult for a third party to prove that the substitution of a sub-contractor should have done under the procurement rules and further asked what was to be gained out of such a challenge.

³⁶ PubSA#4.

Chapter 12 The PFI procurement practice

12.1. Introduction

Chapters 5 to 11 have analysed seven specific legal uncertainties of PFI procurement and outlined the experiences of practitioners in resolving those problems and uncertainties.

Chapter 12 will examine PFI procurement practice from an outsider and an insider perspective. It will firstly, explore in section 12.2. whether there is such a thing as a PFI procurement practice. Having concluded that such a practice does exist this section will then take a closer look at the forces and institutions which supported its emergence.

Section 12.3. will then describe cornerstones of the practice from an insider perspective. We have seen in the foregoing chapters dealing with specific legal problems and uncertainties that procurement law and PFI procurement practice diverge to a varying degree. It has been suggested that although the practice might not be fully compatible with the detailed procedural rules of procurement law, it might be compatible with the principles and aims underlying the Directives.

Section 12.4. will examine the impact of the law in the books on the law in practice from an outsider and an insider perspective. From the possible incompatibility of the strict interpretation of procurement law and the PFI practice the question arises what risks are attached to this conflict.

Section 12.5. will explore the risks stemming from the review system in place considering the insider and the outsider perspective. It will also describe how authorities assessed the risks arising from not strictly complying with the law.

12.2. Development of PFI procurement practice

Section 12.2. will firstly outline whether it is justified to refer to the solutions developed in PFI procurement as a “legal practice.” Having discussed the existence of PFI procurement practice, the question arises at a second stage which forces and

institutions supported the emergence of the practice. The issues to be addressed include the question of why authorities and their legal advisors considered it necessary to diverge from a strict interpretation of the rules. At a third stage it has to be asked in section 12.2.3. whether an institution co-ordinated the emergence and coherence of the legal practice.

12.2.1. Existence of a legal practice

We have seen in chapters 5 to 11 that legal advisors developed solutions to legal uncertainties and interpretations of procurement law which resembled each other. Section 12.2.1. will discuss whether those similarities justify using the term “legal practice” or whether they occurred by coincidence. We have seen in section 4.1.4. that MacIntyre defines practice as “any coherent and complex form of socially established cooperative human activity which has its own standard of excellence.”¹ To enter into a practice as a participant therein involves accepting the standards of excellence and to subject one's own attitudes and preferences to the standards which currently define the practice.² However, the participants' acceptance of certain standards and behavioural patterns does not entail that practices are internally of homogenous and uniform nature. Whilst participants will share the basic standards of the practice, their attitudes as regards to risk-taking may yet vary. The remainder of the section will examine whether the solutions and interpretations adopted are sufficiently coherent to justify using the term “practice.”

This question will be discussed in the light of the solutions adopted by practitioners when confronted with the seven legal uncertainties the study dealt with in chapters 5 to 11.

Chapter 5 has shown that despite legal uncertainties and various approaches to interpret the law, legal advisors have commonly accepted pre-tender negotiations as an essential tool in the procurement process. Conducting pre-tender negotiations has

¹ MacIntyre, op.cit., note 23 of ch.4, pp.187-188.

² *Ibid.*, p.190.

become standard practice for authorities to gauge the interest of the market and to be provided with information on how to draw up specifications. Especially in pathfinder projects or in projects without precedence it is common practice to consult potential contractors prior to commencing the procurement process. To embark on pre-tender negotiations is suggested by both H.M. Treasury and the National Audit Office and is laid down in government guidance.

Secondly, respondents to the study commonly accepted the necessity of amending and changing project specifications after publishing the contract notice. We have seen in chapter 6 that practitioners perceived specifications of PFI projects as inherently flexible and evolving throughout the procurement process. As a result, specifications were substantially altered in some projects, probably requiring the re-advertisement of the project agreement. However, PubSA#4 thought that re-advertising a contract on the basis of changed specifications would not be a viable option in most situations, because authorities had to observe timescale constraints. Even if the underlying specifications had changed substantially and notwithstanding the significant legal uncertainties, legal advisors adopted the practice of not re-advertising PFI contracts.

Thirdly, chapter 7 has shown that irrespective of legal uncertainties surrounding the question of how to classify multi-faceted PFI contracts it was standard practice in PFI to classify project agreements as services contracts. We have seen in chapter 7 that this applies even though practitioners used two different tests to ascertain whether the PFI in question was a works, supplies or services agreement for the purposes of the rules. Individual lawyers criticised the standard practice but mentioned that it was firmly based on the guidance provided by H.M. Treasury.

It is noteworthy that some practitioners even subjected their interpretation of the law to the interpretation of the common practice. BothSA#3, for example, thought that some of the schemes should be classified as contracts for works, contrary to central

government policy. However, he advertised the contracts as services in order “to keep them [meaning central government departments] happy.”

Fourthly, regarding the question of which procedure to employ, practitioners consistently opted for the negotiated procedure, irrespective of differences in assessing the risks and interpreting the law. Respondents adopted this standard solution because they considered the negotiated procedure as the only procedure provided by procurement law to be flexible enough to accommodate PPPs. Though lawyers were aware of the legal uncertainty, they felt that for reasons of commerciality and practicability this practice was justified. Practitioners said they would diverge from the widely accepted practice only under very special circumstances.

We have seen in chapter 9 that it was commonly accepted to employ award *and* qualification criteria at shortlisting stage. Most lawyers were aware of the practice being not compatible with the law in the books, especially with respect to the use of questionable shortlisting criteria, which have been discussed in section 9.2. The reason for diverging from the law was to gain procedural flexibility and a wider choice of shortlisting criteria. Project related shortlisting criteria have provided authorities with opportunity to eject bidders from the award process at an earlier stage in the process than perceived by the law and may thus result in cost savings for both sides.

It is one result of chapter 10 that lawyers support different interpretations regarding the question of whether SPVs operating in the utilities area fall within the ambit of procurement law. Despite significant differences in interpretation, all lawyers with experience in the utilities area agreed that the SPVs should in practice rather not follow the rules so as to sustain their economical viability. Hence, not to advertise the sub-contracts of the SPVs' shareholders may be characterised as part of the standard procurement practice in PFI.

Finally, we have seen in chapter 11 dealing with the step-in rights of project lenders that the veto grounds for authorities were commonly modelled at the qualification criteria contained in the Directives.

It can be concluded from the analyses in chapters 5 to 11 that practitioners developed coherent solutions when faced with seven legal uncertainties in PFI procurement. Considering the differences between individual PFI schemes in various sectors, the degree of coherence of the practice may be considered surprising.

Practitioners accepted common standards in spite of differences in interpretations and nuances in approach, which were often based on the varying assessment of risks. In addition, some respondents subjected their own attitudes and interpretations to the attitudes and interpretations of PFI procurement practice and accepted its normativity.

Having regard to the coherence of the solutions developed in PFI procurement, it is justified to refer to them as PFI procurement “practice” for the purposes of MacIntyre’s definition. The reasons for this coherence of PFI procurement practice will be discussed in sections 12.2.3. and 12.3.

12.2.2. Reasons for establishing the practice

Having ascertained the existence of a PFI procurement practice, we will turn in this section to the question of why the practice was established. One reason for establishing PFI procurement practice could be the possible lack of compatibility between the law in the books and the commercial requirements of PFI schemes. The possible lack of compatibility may have ultimately resulted in legal uncertainties in applying the norms. Chapters 5 to 11 have used seven examples of uncertainties which contracting authorities regularly encountered when seeking to accommodate PFIs within the rigid regime of regulated procurement.

The first example of a divergence between the commercial reality of PFI procurement and the requirements of procurement law is the question of whether authorities are permitted to conduct pre-tender negotiations. We have seen in chapter 5 that it is uncertain whether authorities could conduct pre-tender negotiations without strictly observing the principles of transparency and equal treatment. On the other hand, pre-tender negotiations provide authorities with undisputed commercial benefits.

This uncertainty is particularly relevant in pathfinder projects where the authority could not rely on previous experience in similar projects.

Secondly, chapter 6 has described the rules on specifications as the most significant hurdle to conducting post-tender negotiations and to changing the project specifications in any substantial manner. While the rules probably require that the awarded contract has to be consistent with the terms of its original advertisement in the OJEC, the commercial practice requires ample scope for innovative input from the bidders throughout the procurement process. This important potential problem may be avoided in practice by carefully drafting the initial contract notice.

A practically less relevant uncertainty of the law in the books is the treatment of mixed contracts.³ We have seen in chapter 7 that despite the insistence of the rules to classify the contracts according to the three classical categories works, supplies and services, it was one of the rationales underlying PPPs to combine at least two of those contract types to realise efficiency gains.

One of the most important divergences the law in the books and the commercial reality of PPPs is the use of the negotiated procedure in PFI. We have seen in chapter 8 that as a matter of practicality neither the restricted nor the open procedure is adequate to secure workable solutions in the overwhelming number of PFI schemes. Nevertheless, the European legislator has not yet implemented a specific derogation making the negotiated procedure accessible to PPPs on a regular basis.

A further important divergence between procurement law and the requirement of the PFI practice is the prohibition of project related shortlisting criteria. The legal analysis of chapter 9 has highlighted that authorities are not permitted to shortlist bidders prior to the advertisement of the ITN according to criteria related to the proposed solution. Strict compliance with this legal requirement prolongs the award

³ In practice, many authorities have classified their PFIs as contracts for services without considering the legal uncertainties in great detail. The repercussions of this behaviour for bidders are perceived by practitioners as negligible. See section 7.3.1.

process and increases the transaction costs for authority and bidders alike. It is noteworthy that the number of competitors may be reduced by reference to project-specific criteria after the ITN.

Chapter 10 has examined the treatment of consortia in the PFI bidding process. It was one conclusion of the legal analysis that SPVs operating in one of the “relevant areas” of the Utilities Directive probably fall within the ambit of procurement law and therefore have to advertise their sub-contracts. The possible requirement of the law in the books diverges sharply from the practical requirements in a PFI scheme and threatens the viability of PPPs in important areas of the public infrastructure including public transport.

Finally, chapter 11 has shown that it is uncertain whether project financiers are required to advertise the project agreement or sub-contracts in accordance with the rules when they replace a failing SPV or sub-contractor. Advertising and awarding a contract under those circumstances in strict compliance with procurement law is submitted to be inconvenient and costly for all parties involved, as it considerably prolongs the replacement process.

From the seven examples, one can conclude a degree of divergence between procurement law and the commercial requirements of PFI schemes or at least significant uncertainty. From an outsider perspective, the divergence or uncertainty may be considered as the main reason why the legal practice opts in all seven areas for the most “workable” and economically most viable solution to the legal uncertainties. The divergence between the legal framework and the commercial reality faced by authorities therefore fostered the development of a more workable legal practice.

12.2.3. Co-ordinated development of the practice

While the foregoing section explored one reason for the development of the legal practice, the following section will address the question of whether the emergence of PFI procurement practice was institutionally co-ordinated.

It is submitted that H.M. Treasury and Treasury Taskforce (TTF) played a pivotal role in the development of PFI procurement practice. Many lawyers acknowledged this role and recognised the “political steer” it applied to the process.⁴ An important means to apply political pressure has been the publication of guidance notes on specific problem areas in PFI procurement. The players in the market treat those guidance notes as an authoritative touchstone when it comes to interpreting the procurement rules. Although some lawyers recognised the guidance as “more wishful thinking than anything else,”⁵ “misleading”⁶ or in parts “complete nonsense,”⁷ the notes have formed in many areas the undisputed starting point for further discussion. This practice resulted in the situation that lawyers provided legal advice based on the TTF guidance, despite knowing that “this is incoherent with the rules.”⁸

Another way in which the Treasury has influenced the PFI procurement process has been to pressurise public authorities if they deviate from the TTF guidance.⁹ Lawyers, such as PubSA#4 and PubSA#8, indicated a “strong political steer from the centre” that the guidance notes were adhered to.¹⁰ In some cases, legal advisors to private sector companies stepped up the pressure on the authority by complaining to the Treasury which then intervened on their behalf.¹¹

*Because of the TTF guidance notes and the pressure applied on authorities to comply with them, authorities were interested to follow the guidance notes although their legal advisors might suggest adopting a different approach.*¹² PubSA#7 said:

In the beginning, we doubted whether it was right to use the negotiated procedure. However, Treasury guidance said: use it

⁴ PubSA#4, PubSA#8, PubSA#9.

⁵ PubSA#7.

⁶ PubSA#3.

⁷ BothSA#3.

⁸ BothSA#3.

⁹ PubSA#3.

¹⁰ PubSA#8.

¹¹ BothSA#1.

¹² PubSA#4: “In the beginning we doubted whether it was right to use the negotiated procedure. However, Treasury guidance said: use it and it seems to be an accepted norm in terms of the U.K. authorities.”

and now it seems to be an accepted norm in terms of the U.K.

authorities.¹³

PubSA#8 described a project, where she suggested employing the restricted procedure. However, the TTF raised concerns on this issue. “There was a real drive from the Treasury, but of course it is not really the Treasury which is at risk.”

PubSA#8 added the market for legal advisors was competitive. Combined with the lax TTF guidance, the pressure was on conservative advisors to adopt more relaxed views. PubSA#8 added many authorities did not want to be told not to adopt a flexible and relaxed approach. The pressure applied by the Treasury on authorities seems to have developed an indirect effect on conservative legal advisors. “If lawyers are told, for example, that PFI comes within the derogations of the procurement rules, they will convince themselves that the words fits the facts.”¹⁴ It was interesting that almost all respondents¹⁵ explained they always procured PFIs under the negotiated procedure. After a discussion of the issues involved many of them agreed that the PFI procurement practice was from a legal point of view rather questionable.

The Treasury also defends PFI procurement practice against challenges from outside. PubSA#3 mentioned that authorities were reassured that as long as they complied with TTF guidance, central government would support them. PubSA#4 added that this applied irrespective of whether their actions complied with procurement law. PubSA#3 mentioned the central government backing encouraged authorities to “go ahead” and to accept more risk with respect to the procurement process.

There are indications that the political steer and the pressure applied did have impact on the PFI market. Lawyers decided to “go with the flow at the end of the day.”¹⁶ PubSA#4 felt it would be “quite odd if you would not” do so. Accordingly,

¹³ PubSA#7.

¹⁴ PubSA#4.

¹⁵ Apart from those with experience in employing the restricted procedure, such as PubSA#3.

¹⁶ BothSA#3.

authorities took a “safety in numbers”¹⁷ approach and were “taking additional comfort from the fact that other authorities are pursuing the same practices.”¹⁸

It is noteworthy that the advice given by Treasury Taskforce and the Treasury is not legally binding. Authorities are not under administrative requirement to follow that guidance. This means in particular that if authorities decide for whatever reason not to follow the Treasury guidance this decision will not result in the authority being sanctioned. On the other hand, authorities which approached the TTF for project specific advice will carefully consider any recommendations provided. PubSA#6 observed that the lower down the awarding public sector body was in the hierarchy, the less likely it had latitude to take its own view on procurement issues and the more were those issues influenced by the centre.

It can be concluded that a coherent PFI procurement practice partly emerged as a result of H.M. Treasury’s commitment to make the PFI scheme a success. The practice was assertively developed in an institutionalised and co-ordinated way and did not accidentally result from authorities reaching similar interpretations under comparable circumstances.

12.3. Characteristics of PFI procurement practice

Having at least partially established why and how PFI procurement practice emerged, the question arises which are the main characteristics of the practice from an insider perspective. When confronted with the discrepancy between the requirements of their daily practice and the rigid procedures of procurement law, practitioners mentioned they adopted a “commercial” or “pragmatic” approach to applying the law.

The following section investigates what both terms meant to respondents and how they justified the adoption of practices which appeared risky when viewed from a strict interpretation of procurement law.

¹⁷ PubSA#8, PubSA#10.

¹⁸ PubSA#8.

12.3.1. “Commerciality”

The lawyers interviewed agreed that one cornerstone of the success of PFI was the adoption of a more “commercial approach” to procurement than envisaged by the procurement rules. The often-quoted “commerciality” of PFI seems to comprise that authorities and contractors engage in negotiations throughout the process. Authorities not only award a one-off contract but negotiate a long-term partnering agreement.

Negotiations are a characteristic feature of the whole PFI procurement process, from the technical dialogue in the pre-tender phase to final negotiations with the preferred bidder. Thereby, the awarding authority acts like a private sector business rather than a public sector body. The slogan “deals not rules,” which was employed in the early days of PFI, captures this approach fittingly. Adopting a “businesslike” approach implied that rigid public law constraints placed on authorities must have appeared too burdensome and too inflexible to them in the light of the complex procurement tasks.

One feature of the commercial approach was that authorities weighed the benefits of complying with the procurement rules against possible detriments, despite their obligation to comply with the letter of the law.¹⁹ For instance, when choosing the award procedure, authorities and their legal advisors balanced the risk of being effectively challenged on using the negotiated procedure against the benefits of the gains in flexibility. It is noteworthy that government guidelines and NAO reports constantly demanded the adoption of a commercial approach and the acquisition of commercial skills.

We have seen in chapter 3 that one of the major goals of European public procurement law is to achieve commercially orientated public procurement. It is for this reason that lawyers perceived the Commission’s stance on issues such as the use

¹⁹ Many practitioners confirmed this practice, such as: BothSA#2; PubSA#2; BothSA#6.

of the negotiated procedure as “hypocritical.”²⁰ BothSA#1 remarked the Commission supported infrastructure projects such as PPPs as part of the Trans European Networks (TEN) programme. On the other hand, the Commission criticised authorities for adopting a “commercial and flexible approach” which practitioners held to be necessary for the realisation of those projects.²¹ PubSA#9 identified a “conflict of policies”²² and added “the aim of transparent procurement market in Europe stands against letting the projects happen and not burying them in red tape.”²³

Lawyers were unambiguous in their support for a commercial and flexible approach, which has helped to evolve and develop the projects and the PFI scheme in general. PrivSA#1 and PubSA#1 observed that the commercial approach in PFI facilitated the emergence of commercially oriented government procurement in the United Kingdom.²⁴

12.3.2. Pragmatism

Interviewees said they opted for a “pragmatic approach” to the rules when confronted with a multitude of procedural problems and uncertainties.²⁵ Apart from the explicit reference to pragmatic, practical or “workable”²⁶ interpretations of procurement law, respondents employed terms such as “just do it,” “get the job done,” “just go ahead”²⁷ or even “make it fit” when referring to the application of procurement law in PFI.

With respect to the negotiated procedure, PubSA#4 observed that “although the grounds for using it are making it a real exception, people just made it fit.” PubSA#3 gave a reason for the “go ahead” approach in saying that “if they [the public sector clients] feel they have the U.K. government behind them, they go ahead and take more

²⁰ PubSA#9.

²¹ BothSA#1.

²² PubSA#9.

²³ PubSA#9.

²⁴ PrivSA#1; PubSA#1.

²⁵ Many, for example: BothSA#1; PrivSA#6; PubSA#3; PubSA#2; PrivSA#1; PrivSA#2; PrivSA#3.

²⁶ PrivSA#3.

²⁷ BothSA#4.

risk.” It is of note that authorities and their legal advisors also had recourse to the term “pragmatism” to describe a legal practice which is based on “working around”²⁸ or even “ignoring”²⁹ the applicable rules. By calling the solutions “pragmatic,” lawyers suggested a degree of necessity to bend the rules or to adopt risky approaches. When employing the term “pragmatism” respondents indicated to outsiders, and possibly to themselves, that they were forced into the practice by externalities beyond their control; for instance deficiencies of the legal framework.

BothSA#3 defended his public sector clients and said, “it is not that people don’t want to comply, it is just that they get swamped by unforeseen circumstances” resulting, for example, in changes in the specifications.³⁰ BothSA#3 perceived the pragmatic approach as a natural reaction to a set of rules that “were not drafted with PFI projects in mind.”³¹

Another related aspect emerging from the interviews is that all lawyers were aware of the legal uncertainties discussed in chapters 5 to 11 above. BothSA#3 acknowledged he was

“skating on thin ice in a procurement sense all the time.”

PrivSA#3 explicitly said he had an “uncomfortable feeling” regarding the interface of PFI procurement practice and the procurement rules. BothSA#3 said that

*“illegality is leaning over us all the time.”*³²

The awareness of the legal uncertainties was said to stand back when advising on projects.³³ The knowledge of the problems on the one hand and the “pragmatic” approach on the other led to the phenomenon that lawyers clearly distinguished between “theory” and “practice.” PubSA#1 suggested that both were “hardly

²⁸ PrivSA#3.

²⁹ BothSA#6.

³⁰ BothSA#3.

³¹ BothSA#3.

³² BothSA#3.

³³ PubSA#1.

reconcilable.”³⁴ Respondents, such as PubSA#3, said they would usually flag the “academic” or “theoretical” viewpoint³⁵ on the most pertinent procurement issues. BothSA#2 mentioned his clients were saying “we are aware of the risk you have outlined to us and we are prepared to take them.” PubSA#3 reported that some of her public sector clients felt “very, very uncomfortable” about adopting pragmatic solutions.³⁶ In the end, they gave in to the political pressure from central government bodies and the pressure arising from the PFI procurement practice.³⁷ Hence, not only legal advisors deliberately decided against a strict interpretation of procurement law, but also some of the public authorities. As PubSA#9 put it:

“What authorities want is not a public procurement problem but the school.”

Irrespective of the rigid rules, PubSA#4 said that public sector clients wanted

*“to negotiate things out. If they are forced into the restricted procedure they will go on with their negotiations and will do it quietly. Alternatively, they will ignore the procurement Regulations.”*³⁸

The statement reveals the intention on the side of authorities to apply procurement law only in circumstances where it appears not to have negative impact for the purposes of the project.

Decisions on procurement issues were not only made on the basis of legal advice but also after consultations with financial advisors. PubSA#4 said the latter tended to support the adoption of a pragmatic and workable solution. Another force encouraging rule bending “pragmatic” solutions are senior government departments, such as the Treasury and the respective central government department. They have a significant

³⁴ PubSA#1.

³⁵ PubSA#3.

³⁶ PubSA#3.

³⁷ The latter will be discussed further below.

³⁸ PubSA#4.

political interest in “making PFI work,”³⁹ even if this implies working “pragmatically” around the rules.⁴⁰ PubSA#1 maintained that nobody in the trade was challenging or even questioning the “just do it” or “just go ahead” attitude of public sector bodies.⁴¹ We will return to this occurrence below.

Central government and the participants in the market endorsed breaches of the law in the books for the sake of “making the projects work.” The “pragmatic” approach of the PFI practice therefore reflects a widespread disrespect for procurement law, which has been institutionalised by means of government guidance.

12.3.3. Superiority of the U.K. system

Lawyers praised the superiority of the “commercial” and “pragmatic” over a “theoretical” approach to procurement law. They asked why the U.K. should settle for a less commercial and less flexible regime because other European countries and the Commission were years behind in the development of efficient procurement practices.

Those questions were discussed in the light of the Commission’s proposals for reforming procurement law and its reasoned opinion in the *Pimlico* case. BothSA#3 openly remarked that

“if you breach the rules, so what? Our system works and I want to do what we are doing without constraining ourselves as it is proposed by the Commission.”

Other lawyers observed that although PFI procurement practice did not coincide with a strict interpretation of the rules, they would prefer the practice to prevail over a strict application of the procurement rules. PrivSA#1 was clear in saying that

“we should drag the rules to the practice rather than the practice to the rules.”

³⁹ PrivSA#3.

⁴⁰ See for the role of H.M. Treasury above section 12.2.3.

⁴¹ PrivSA#6.

PubSA#1 mentioned she thought the procurement rules were rather applicable to southern European countries with greater problems of irregularities and corruption in procurement processes than the United Kingdom.⁴² In this context, some respondents perceived public procurement law as an unnecessary burden which was introduced by European bureaucrats lacking practical experience in procurement.⁴³ PubSA#1 maintained that procurement law obstructed the development of “commercial” and “pragmatic” procurement practices in the U.K.⁴⁴

Respondents perceived that PFI procurement practice was superior to the law and combined this statement with the opinion that breaches occurring in the PFI process were of mere “technical” nature. Lawyers who uttered this view suggested that the breaches were by no means material, because foreign bidders, if they eventually materialised, were not discriminated against. BothSA#3 stated the rule of law was very strong in Britain: “We don’t mess around with the specs and award criteria.”⁴⁵ PrivSA#5 added the transparency of the projects was warranted through internal auditing procedures within the public sector, which would detect any blatant breaches of procurement law.⁴⁶ All lawyers were well aware of the fact that the “superior” PFI procurement practice was developed by disregarding and bending the procurement law.

12.4. Impact of the law on PFI procurement practice

Having explored the cornerstones of PFI procurement, we will discuss in the following section the impact procurement law has had on PFI procurement practice. To examine the impact we will first adopt an outsider perspective before turning to the perception of insiders.

12.4.1. Impact of the rules on the practice from an outsider perspective

⁴² BothSA#4, “I don’t want to be nationalistic, but...”.

⁴³ PubSA#7; BothSA#3, “when do they come to grips with reality?”

⁴⁴ PubSA#1 .

⁴⁵ BothSA#3.

⁴⁶ BothSA#3; PrivSA#5.

Various writers have tried to specify the conditions under which law can effectively influence behaviour and perhaps attitudes. Three most commonly discussed conditions will be explored in the following section. From an outsider perspective, section 12.4.1.1 will firstly consider whether practitioners accepted rules and values competing with procurement law. In a second stage it will be analysed to what extent the competing rules and values do actually deviate from procurement law. Secondly, section 12.4.1.2. presents a potential condition for Community law to have impact on national legislation, namely the legal implementation into national law. Section 12.4.1.3. will ask whether procurement law has been re-evaluated to keep it up-to-date with socio-economic developments and thus to maximise its potential impact. The two remaining pre-conditions for the law to maximise its impact, diligence of enforcement and benefits from compliance will be dealt with when addressing the question of how procurement law was enforced in PFI in section 12.5.

12.4.1.1. Competing rules and values

The first condition for law to make an impact is that social actors should not accept rules and values competing with the norms under consideration. If the addressees have accepted other rules and values it has to be further asked to which degree the competing norms deviated from each other. Both aspects will be considered from an outsider perspective.

It is suggested that procurement Directives and Regulations are not the only source of guidance for PFI procuring authorities. Public procurement law has to compete with sector specific guidance and with a variety of central government guidance on the PFI procurement process. It has been explained that sector specific and central government guidance were repeatedly incompatible with a strict approach to procurement law as reflected in the jurisprudence of the European Court of Justice.

The government guidance fostered the adoption of a lax approach to procurement law which significantly influenced the PFI procurement practice.⁴⁷

PFI procurement practice may be viewed as another set of rules and values competing with public procurement law. Although the practice lacks normativity and is, in contrast to the government guidelines, not even put down in writing, it considerably influenced the behaviour of authorities and their legal advisors. Since the PFI scheme was launched in November 1992, PFI procurement practice has been consistently developed and built on the TTF guidance and previous experience. Procedural cornerstones of the practice include *inter alia* the successive refinement of output-based specifications and the use of the negotiated procedure.

PubSA#4 reported she felt it was difficult to leave the trodden paths of PFI procurement practice in favour of a more robust approach to the law. She further observed that it was “quite odd” not to use the negotiated procedure because it was likely to alienate public sector clients. Her assessment shows that practitioners and their public sector clients thought of the practice as having normative character.

From an outsider perspective, the general theme occurred that authorities considered only those parts of the law that appeared not to have a significantly negative impact on their project. Authorities adopted some procedural elements, such as the OJEC advert and broadly the structure of the negotiated procedure. In other areas, including the use of the negotiated procedure, they deliberately chose not to follow other legal obligations and abided by the TTF guidance instead. In taking into account commercially oriented considerations and pursuing “best practice,” contracting authorities have accepted rules and values other than the strict interpretation of the procurement rules.

The procurement rules have to compete in PFI procurement therefore not only with government guidance but also against a grown legal practice, a well-established

⁴⁷ See for the role of H.M. Treasury above section 12.2.3.

“law in action.” It is submitted that both sets of competing norms limited the impact of procurement law on PFI procurement practice.

In applying the second limb of the concept, it has to be asked how far the competing norms and values deviated from the strict approach to the procurement rules. PFI procurement practice as well as governmental guidance were considered to compete with the procurement Directives and we have seen in chapters 5 to 11 that both deviate from a strict interpretation of procurement law.

Nevertheless, the competing rules could be in line with the principles underlying the procurement Directives, such as competition, transparency, non-discrimination. Although this question does not affect the fact that the practice deviates from the rules of the Directives, it may help to explain the degree of normative deviation and to assess the degree of impact procurement law has had on the practice.

The principle of “equality of treatment,” or “non-discrimination,” requires that similar situations are not treated differently unless this is justified by objective reasons.⁴⁸ It prohibits not only obvious discrimination based on nationality, but also covers forms of discrimination which lead de facto to the same result.⁴⁹ According to practitioners⁵⁰ and the publicly available case studies, cross-border penetration in PFI procurement was minimal. PubSA#2 remarked that PFI contracts were awarded to U.K. based subsidiaries of French and German companies and many PFI consortia had foreign shareholders. She did not come across any discriminatory practices in PFI. The study also did not find any evidence suggesting that PFI procurement practice compromised the non-discrimination principle.⁵¹

⁴⁸ Case 810/79 *Überschär* [1980] E.C.R. 2747, para 16 of the judgment; Case C-243/89 *Storebaelt* [1993] E.C.R. I-3353.

⁴⁹ This covers even measures of non-discriminatory nature, for example: the requirement that the firm to be awarded the contract should be owned by the [Italian] government, cf. Case C-3/88 *Data Processing*, [1989] E.C.R. 4035, para 8 of the judgment.

⁵⁰ BothSA#1

⁵¹ However, in the *Harmon* case, which was not procured under PFI, *Harmon CFEM Facades (U.K.) Ltd v The Corporate Officer of the House of Commons*, High Court; judgment of 28 October 1999, the House of Commons sought to discriminate against a French contractor on grounds of nationality.

A further principle underlying the European public procurement Directives is transparency. It aims to ensure undistorted Community-wide competition between operators in the market and allows the latter to monitor compliance with procurement law. The ECJ held that a non-distorted system of competition can only be guaranteed if the various economic players have equal chances in transparent procurement procedures.⁵² The principle therefore requires that participants know the clearly drafted⁵³ “rules of the game.”⁵⁴ Further, procurement procedures should be formalised and transparent *inter alia* by employing objective selection and award criteria when tendering the contract.⁵⁵ Companies must be furnished throughout the process with “precise information concerning the conduct of the entire procedure.”⁵⁶ The transparency principle may take also effect in the process after bids have been received and before the selection of the preferred bidder. At this stage, the principle imposes restraints on how negotiations are to be conducted. The ECJ held in the *Walloon Buses* case⁵⁷ that it was a breach of the equality and transparency principle to provide only one bidder with the opportunity to amend its offer without giving such an opportunity to other competitors.

In contrast to the principle of non-discrimination, it is more difficult for an authority to achieve perfect transparency in a project as complex as a typical PFI. Whilst it is certainly possible to brief bidders on the general rules of procedure, authorities found it difficult and inconvenient to publish their award criteria at the

⁵² Case 87/94 *Commission v. Belgium “Walloon Buses”* [1996] E.C.R. I-2043, para 55 of the judgment.

⁵³ Westring/ Jadoun, *Public Procurement: Manual for Central and Eastern Europe* (1996), p.6.

⁵⁴ Arrowsmith/Linarelli/Wallace, op.cit., note 63 of ch.5, p.74.

⁵⁵ On the balance of the both procurement principles “transparency” and “value for money” see: *Ibid.*, p.73 ff.

⁵⁶ Case T-203/96 *Embassy Limousines & Services v. European Parliament* (unreported) para 85 of the judgment.

⁵⁷ Case 87/94 *Commission v. Belgium “Walloon Buses”* [1996] E.C.R. I-2043, para 54 of the judgment.

beginning of the proceedings without changing them afterwards.⁵⁸ This problem is partly inflicted by the complexity and diversity of the possible solutions.

Authorities sought to solve the issue by employing broad headline award criteria in addition to broad output specifications. Headline award criteria and output specifications have the advantage that the authority may refine them throughout the process. Both practices also seek to avoid re-commencing the procurement procedure because either the specifications or the award procedure were changed after publication of the contract notice. In practice, authorities used both practices in some PFIs to substantially “move the goalposts” of the project. In these cases, transparency was compromised for the benefit of gaining more procedural flexibility. This goes especially if one adopts the view that the transparency principle cannot be separated from the detailed procedural rules of the Directives which authorities find it difficult to strictly comply with.

A further principle underlying the procurement Directives is fair competition between bidders for public contracts. This principle is included in the preambles as one of the main goals of the procurement Directives.⁵⁹ It is further inherent to the fundamental principles of equal treatment and transparency. Opening up procurement markets was pinned to the expectation that this would lead to increased competition between European companies, improved industrial efficiency and competitiveness of European companies in global markets and, finally, reduced purchasing costs of the public sector and utilities.⁶⁰

It is PFI procurement practice to limit the number of bidders in the final stages of the project and thereby reduce competition amongst tenderers.⁶¹ *De facto*, the announcement of the preferred bidder marks the end of the competitive phase of the

⁵⁸ Article 36(2) Services Directive 92/50.

⁵⁹ For example: 14th recital of the preamble of the Supply Directive 93/36.

⁶⁰ European Commission, *op.cit.*, note 10 of ch.1, para 1.13.

⁶¹ Fox/Tott, *op.cit.*, note 5 of ch.2, para 5.7.8 et seq.

tender process.⁶² As the project agreement is only in exceptional circumstances not awarded to the preferred bidder, the bargaining power of the latter in the final stages is disproportionately strengthened and the incentives to offer best value for money is reduced. In order to avoid this situation and to warrant the competitiveness of the negotiations, it is preferable to cover most commercial issues in discussions held before selecting the preferred bidder.⁶³ According to the legal advisors interviewed for the empirical study,⁶⁴ this preferable way of conducting negotiations proved to be unrealistic in practice.

It is possible to conclude from an outsider viewpoint that PFI procurement practice is not always compatible with the principles underlying the Directives. Especially the principles of competition and transparency were compromised for the sake of greater procedural flexibility and commercial considerations. However, although not always compatible with a strict interpretation of the procurement rules and their underlying principles, the PFI procurement practice could be in line with the aims and purposes of the law. The European Directives were aimed at abandoning restrictive and protectionist procurement practices with the additional purposes of fostering the better allocation of economic resources and restructuring national industries.

The legislative framework for public procurement was meant to be “an incentive for major change in traditional purchasing practices in the Member States, thus contributing to an environment favourable to economic development in Europe as a whole.”⁶⁵ According to the Commission, authorities should seek to achieve this aim by ensuring Community-wide competition based on the principles of non-discrimination and transparency.⁶⁶ The “particularly important aim of efficient procurement”⁶⁷

⁶² *Ibid.*; Brazier, “Appointing a preferred bidder” (1999) *PFI Journal* (3), p.14.

⁶³ Arrowsmith(ed.), op.cit., note 24 of ch.2, para 9.189.

⁶⁴ BothSA#3.

⁶⁵ European Commission, op.cit., note 59 of ch.3, para 1.2.

⁶⁶ *Ibid.*, para 2 et.seq.

⁶⁷ European Commission, op.cit., note 113 of ch.3, p.1.

includes the “efficient allocation of resources” eventually leading to the enhancement of public services.⁶⁸

It is suggested that the macro-economic aim of efficient and best value oriented procurement is shared by the Private Finance Initiative. PFI was initially adopted for the reason to enhance the services delivered to the public and to achieve “best value for money,”⁶⁹ meaning to allocate more efficiently the scarce financial resources of the public sector. PFI further represent the “major change in traditional purchasing practices,” the Commission demanded in its 1996 Green Paper. The PFI scheme not only transformed procurement practices in the U.K. but also inspired the adoption of similar schemes in E.U. countries such as The Netherlands, Portugal, and Italy and further abroad in Japan and South Africa.

Despite its congruence with the fundamental purpose of the rules to achieve efficiency in public procurement purpose, the PFI procurement practice is challenged by the Commission for its lax approach towards the rules.⁷⁰

It is submitted that the relaxed approach at least partly reflects the commerciality, meaning efficiency, of PFI projects which the Commission favours. PFI awarding authorities embark on negotiations with bidders because it is commercially more sensible to negotiate the project agreement rather than conducting a rigid tendering process. It is submitted that a co-ordination problem and a “conflict of policies”⁷¹ exist between the macro-economic aims of the procurement Directives and their procedural rigidity. While aiming at commerciality and “efficient purchasing,” the rigid regulatory regime seems to stifle the adoption of more commercially oriented procurement practices.

Another aim of regulated public procurement in Europe was to restructure national industries. It was anticipated that the Single Market would result in a large

⁶⁸ *Ibid.*

⁶⁹ See for further references above section 2.2.5.1.

⁷⁰ With respect to the use of the negotiated procedure, see: “Pimlico” case, European Commission, (2000) *Single Market News* No.23 (October).

⁷¹ PubSA#9.

number of mergers leading to economies of scale through rationalisation of production and the avoidance of duplication in research.⁷² With opening up procurement market, it was predicted that more efficient firms would emerge to serve the whole of the Single Market. There is little comprehensive information on the true picture of the economic impact of procurement policy on the restructuring of national industries.⁷³

The Private Finance Initiative indirectly supports restructuring of private sector industries by persuading companies to collaborate when they bid for public contracts.⁷⁴ Partnership arrangements render it necessary for companies to adopt more efficient approaches as to managing consortia, the supply chains involved,⁷⁵ and the long-term relationship with the public sector partner.⁷⁶ Those methods, which were further developed and refined through PFI, allowed private sector entities to perform more efficiently and, hence, more competitively in other ventures outside the realm of government procurement.

Summing up the findings of the section on rules competing with procurement law, it is suggested from an outsider perspective that the latter was only one source of guidance for authorities. The U.K. Regulations competed with a plethora of general and sector specific guidance notes and, in recent years, with an ever more matured PFI procurement practice.

The latter may not always be compatible with the strict interpretation of the procurement rules. On the other hand, the practice is compatible with the principles of non-discrimination and, to some extent, competition, which underlie the Directives. The PFI practice is also in accordance with two of the main purposes of procurement law, namely to achieve the more efficient allocation of economic resources and to restructure national industries.

⁷² Arrowsmith, *op.cit.*, note 2 of ch.1, p.48.

⁷³ EuroStrategy Consultants, *op.cit.*, note 8 of ch.1, para 7.2.

⁷⁴ CBI, *op.cit.*, note 98 of ch.2, chapter 4 “Fostering private sector capacity.”

⁷⁵ See Cox/Harris/Parker, *op.cit.*, note 135 of ch.2; Saunders, *op.cit.*, note 135 of ch.2.

⁷⁶ See Cox/Townsend, *op.cit.*, note 136 of ch.2; Heal, *op.cit.*, note 136 of ch.2; H.M. Treasury, *op.cit.*, note 136 of ch.2.

The compatibility with some of the principles and aims underlying the Directives suggest that PFI procurement practices does not deviate entirely from the Directives, though the degree of impact can again only be described as limited.

12.4.1.2. National implementation of supra-national rules

Another potentially relevant condition for Community law to be effective is its adequate implementation into national law. It may be useful to recall briefly the relationship between the Member States and the promulgation of Community norms. This relationship can be broken down into four general phases, namely adoption, legal implementation, application, and enforcement.⁷⁷ The first potential point for deviation from Community law is the legal implementation of supra-national Directives into the national legal systems.⁷⁸ This process has attracted especial attention amongst European law lawyers, since it requires the choice between competing values.⁷⁹ Article 10 of the E.C. Treaty puts Member States under a duty to legally implement provisions of Community law to ensure fulfilment of the obligations contained therein. The Treaties establish that after Directives have been adopted by the Community legislature, they are binding on the Member States as to the results to be achieved, but leave the choice of the form and methods by which they are incorporated into national law.⁸⁰

In public procurement law, the Commission has consistently complained about the lack of proper implementation of the procurement Directives into national legislation⁸¹ and, accordingly, vigorously enforced the implementation deadlines of

⁷⁷ Krislov/Ehlermann/Weiler, "The Political Organs and the Decision-Making Process in the United States and the European Community," in: Cappelletti/Secombe/Weiler (eds.) *Integration through Law, Volume 1 Book 2* (1986), pp.61-85.

⁷⁸ Snyder, note 6 of ch.1; Swart, "From Rome to Maastricht and Beyond: The Problem of Enforcing Community Law," in: Harding/Swart (eds.), op.cit., note 99 of ch.3.

⁷⁹ Snyder, note 6 of ch.1, p.21; Lenaerts/ Nuffel, *Constitutional Law of the European Union* (1999), p.458 et.seq.

⁸⁰ Article 249 III E.C. Treaty.

⁸¹ European Commission, op.cit., note 59 of ch.3, para 3.3 et.seq.

the Directives⁸² and the quality of implementation. It has claimed that compliance problems and the limited impact of procurement law result from inapt legal implementation of Community law into national legislation.⁸³ The Commission's claim is not supported, however, by the impact study available in this area.⁸⁴ The *EuroStrategy* study reveals that the way in which the Directives were implemented does not appear to influence the law's impact.⁸⁵

In any case, the legal implementation of the three Public sector and the Utility Directive in the U.K. do not appear to be a relevant factor in explaining non-compliance in PFI. The four Directives were legally implemented in the United Kingdom by means of Regulations in the mid 1990s⁸⁶ in a manner principally consistent with the Directives.⁸⁷ In the few areas where the U.K. Regulations deviate from the Directives, the substantive rules of the procurement Directives⁸⁸ have direct effect and may be directly relied upon against the state and bodies providing services under state control.⁸⁹ The relevance of an adequate implementation is thus further diminished by the direct effect of the salient provisions of the procurement Directives.

It is therefore suggested that the limited impact of procurement law in the PFI context is rather related to the application of the law than to its implementation.

12.4.1.3. Re-evaluation of the law

The third possible precondition for law to have maximum impact on the social context is that it must remain practicable at the time of application and relevant for the legal practice. The growing dynamic of an ever changing economic and societal environment puts the law under pressure to cope with these changes and to adapt to a

⁸² The Commission has consistently launched infringement proceedings against a number of Member States for not implementing procurement Directives on time, e.g.: France and the United Kingdom for not implementing Directive 98/04 (9 March 2000).

⁸³ European Commission, op.cit., note 59 of ch.3, para 3.3 et seq.

⁸⁴ EuroStrategy Consultants, op.cit., note 8 of ch.1, para 7.2.

⁸⁵ *Ibid.*

⁸⁶ See above note 2 of chapter 3.

⁸⁷ For one of the minor differences see: Arrowsmith, op.cit., note 2 of ch.1, pp.123-175.

⁸⁸ For example, the criteria to evaluate bids: Case 31/87, *Gebroeders Beentjes B.V. v. The Netherlands* [1988] E.C.R. 4635, paras 39-44 of the judgment.

⁸⁹ Case C-188/89 *Foster v. British Gas* [1990] E.C.R. I-3313.

changed socio-economic environment.⁹⁰ If the legislator fails to re-consider the law in the light of recent socio-economic developments, it is likely to be bereaved of its relevance. Under circumstances where the regulatory onus appears disproportionate, practitioners are more likely to apply tactics of deviance. Hence, a failure to re-evaluate norms is likely to result in widening the gap between the law in the books and the law in action and thereby limits the law's impact.

To increase the law's impact and not to let it appear irrelevant, the onus placed on applicants has to be constantly monitored and, if necessary, re-evaluated. The process of re-evaluation eventually aims at bringing about specific changes to the rules to keep them relevant.

The European Commission generally acknowledges this notion with respect to public procurement law. It asserts that "the current legal framework does not exist for its own sake but in order to attain the benefits, if the single market in the area of public procurement. Rules, policy and enforcement should follow reality rather than the other way round."⁹¹

The European procurement Directives were successively implemented into the legal systems of the Member States during the 1970s. Then, the procurement rules were consistent with their social and economic environment. They reflected largely the procurement practices employed, meaning one-off works and supply contracts. Procurement law has not changed significantly for the last 30 years despite significant technical developments, including the emergence of e-procurement, and socio-economic developments, such as PPPs.

We have seen in chapters 5 to 11 that tensions between an unchanged legal framework and commercial requirements brought about by socio-economic changes have caused seven considerable legal problems and uncertainties. For each of the

⁹⁰ Similarly: Arrowsmith, *op.cit.*, note 2 of ch.1, p.295.

⁹¹ European Commission, *op.cit.*, note 113 of ch.3, p.2.

uncertainties, it has to be addressed whether the change in the socio-economic environment has resulted in a re-evaluation of the regulatory burden.

In addition, it has to be asked whether the possible failure to re-evaluate procurement law in those seven areas may contribute to its limited impact on the PFI practice. The possible lack of re-evaluation may be one reason why contracting authorities may have deviated from the procurement rules when delivering PFI projects, as this probably offered a way to bridge the gap between the not re-evaluated, and hence inefficient, law in the books and the necessities of the real world.

The first legal uncertainty discussed in chapter 5 was the question of whether authorities are allowed to conduct pre-tender negotiations on various issues. It is submitted that the need for pre-tender negotiations has increased with the emergence of more complex contractual structures. We have seen that from the perspective of authorities, pre-tender negotiations offer significant benefits in gauging the interest of the markets and consulting experts on the public sector comparator and, more importantly, on the question of how to design project specifications.

It was submitted that pre-tender negotiations pay dividends throughout the remainder of the procurement process. Chapter 5 identified the principle of transparency as main obstacle for conducting pre-tender negotiations irrespective of whether authorities employ the restricted or the competitive negotiated procedure. Considering the substantial benefits arising from pre-tender negotiations it may become necessary to re-evaluate the practicability and appropriateness of the legal requirements arising from the transparency principle. As shown in section 5.1.4.1. with the solution adopted in the GPA, pre-tender negotiations can be conducted without necessarily compromising the principle of transparency.

The second area of uncertainty, which was dealt with in chapter 6, was the question of whether changes to the specifications were reconcilable with the rules on specifications of the Directives and their underlying principles, most notably transparency.

Respondents said it was a practical requirement of PPPs to refine specifications throughout the project to adequately consider the innovative solutions proposed by bidders.⁹² While slight amendments to specifications should be compatible with rules and principles, this does not apply to “significantly moving the goalposts of the project”⁹³ after the contract advertisement. This practice is probably neither reconcilable with the rules nor with the transparency principle.

It appears questionable whether the change in the procurement practice should necessarily initiate a re-evaluation of procurement law. It has been argued in section 6.2.4. that the regulatory onus in the case of substantial changes, namely to re-advertise the changed specifications, appropriately balances the interests of bidders interested in the changed project on the one hand and the authority on the other.

The problem of how to classify contracts was described as a third area of legal uncertainty in PFI procurement. We have seen in section 7.2.5. that one rationale of multi-faceted PPPs is the integration of construction and services elements to create efficiency gains. The integration of different contractual elements causes difficulties when classifying multi-faceted contracts according to the three traditional categories of the Directives.

The requirement of classification was developed for contracts with only one predominant purpose. The changes in the economical environment, meaning the introduction of more complex contractual agreements integrating several contractual elements, seem to have outgrown the legal framework. The law in the books has lost its practical relevance in this area and practitioners reported that they deviated from the rules of classification in advertising PFIs in two categories of the OJEC or classifying PFIs constantly as services contract without conducting a case-by-case analysis.

⁹² See above section 6.3.

⁹³ See above section 6.2.

The impact of procurement law may be increased, if the law would have been re-evaluated with respect to the classification requirement to accommodate multi-faceted PPPs more easily.

Probably the most pertinent regulatory onus placed on PFI procuring authorities are the limitations for using the negotiated procedure. Although the Directives were amended in the 1980s and 1990s, those legislative changes did not specifically consider complex procurement task such as PPPs. The archetype of the procurement process remains a Community-wide contract advertisement followed by a one-stage tendering procedure and the subsequent award of the contract applying either the “best price” or the “most economically advantageous” criterion. Tendering public contracts, as envisaged by the Directives, is a sufficiently flexible method for authorities to competitively award the overwhelming number of their one-off works, supply, or services contracts.

It has been suggested that rigid tendering processes are incapable of accommodating large-scale concession contracts and PPPs. The latter rather require ongoing negotiations throughout their procurement process.⁹⁴ The complexity of their contractual structure and the exceptionality of the individual project for the procuring authority require extensive negotiations with bidders and project lenders on issues such as drawing up specifications, financing and structuring the deal. This assumption was unequivocally supported by all respondents to the empirical study and is not contested in the academic literature.⁹⁵

What is more, conducting negotiations freed from the straightjacket of a rigid tendering mechanism is said to reduce the time and costs of the award process.⁹⁶ Participants in negotiations can resolve uncertainties, ambiguities and errors present in

⁹⁴ Bulow/Klemperer, *Auctions vs. Negotiations* (1994), see for a summary of the arguments: Klein, “Infrastructure Concessions – To auction or not to auction?” (1998) *Public Policy for the Private Sector* (Nov.), No.159.

⁹⁵ See for example: Arrowsmith, op.cit., note 2 of ch.1, p.723.

⁹⁶ For a discussion see: Peckinpugh, *Government Contracts for Services* (1997), p.155 et seq.

the proposal leading ultimately to a more accurate evaluations and more definitive contracts. Furthermore, negotiations based on outline specifications can leave the private sector free to propose innovative solutions. Private sector companies might be more willing to present unsolicited project proposals such as new solutions to a known problem, or new ways of defining performance standards.⁹⁷ Comparing and evaluating bids in a negotiation process provides the authority with much greater discretion than within the tightly regulated framework of a tendering process.

Despite the benefits of negotiations, European procurement law still seeks very much to limit the authority discretion by creating obstacles to embark on negotiations with interested firms. The European legislator seems to perceive discretion solely as a means for the department to introduce discriminatory and non-transparent procurement practices. Discretion is less viewed as providing authorities with the opportunity to introduce more commercially oriented procurement practices and as ensuring “best value” in public procurement, which is an aim of European procurement law.⁹⁸

Employing the negotiated procedure under E.U. law is still considered by the European legislator as an exception and remains linked to the fulfilment of certain conditions. It can be concluded that due to the emergence of more complex forms of procurement such as PFIs it has become necessary to provide authorities procuring those exceptional deals with the opportunity to conduct negotiations. In this area, lawyers perceived the regulatory onus as disproportionate and therefore applied tactics of deviance in conducting negotiations despite knowing that the derogations were not always satisfied.⁹⁹ It is for this reason that the procedural rules of the Directives in their not re-evaluated form may compromise the impact of procurement law on PFI procurement practice.

⁹⁷ Klein, *op.cit.*, note 94, p.2.

⁹⁸ European Commission, *op.cit.*, note 59 of ch.3, para 2.2.

⁹⁹ See above, chapter 8.

The fifth legal uncertainty, discussed in chapter 9, dealt with questions surrounding the criteria for selecting and shortlisting bidders and awarding contracts. We have seen in section 9.3.1. that PFI practitioners perceived it especially difficult to decide which criteria to employ in shortlisting bidders.

While the Directives probably require the use of qualification criteria at shortlisting stage, PFI procurement practice also considered award criteria to whittle down the number of tenderers. The practice to consider project-related criteria has the benefit in complex projects to substantially accelerate the procurement procedure and to base the shortlisting decisions on more relevant information. The reduction of bidding costs may be employed as additional argument for considering criteria related to the project even prior to the ITN.

On the other hand, authorities are permitted to employ award criteria after the ITN was issued. From this perspective, the regulatory burden placed on the addressees regarding the shortlisting of bidders may not be considered as disproportionate. Though the rules may be inconvenient to apply in practice, their re-evaluation may be deemed unnecessary to increase their impact.

The sixth legal uncertainty dealt with in chapter 10 was the question of whether intra-consortium contracts, especially in the Utilities area, come within the realm of the Directives. The result of the legal analysis that SPVs operating a “relevant activity” for the purposes of the Utility Directive probably have to advertise the sub-contracts which were initially destined for the SPVs’ shareholders.

This requirement has been identified in chapter 10 as threatening the economical viability of bidding consortia. Companies vested with different skills establish consortia and SPVs for the sole purpose of dividing the sub-contracts amongst them. Demanding the advertisement of sub-contracts would render bidding consortia in PPPs unworkable. It is for this reason that the regulatory burden placed on the addressees of the law appears disproportionate.

As shown in section 10.3.2., the disproportionate regulatory burden has already provoked strategies of deviance and probably undermined the impact of procurement law on the legal practice. It is submitted that the probably necessary re-evaluation process could be modelled on the proposed Article 4 of the amended proposal for the Utilities Directive. This provision, which was not implemented into the current law, largely exempted intra-consortium contracts from its realm.¹⁰⁰

The final legal uncertainty discussed in chapter 11 was the question of whether the exercise of step-in rights may trigger the procurement rules. We have seen that despite the fact that the post-award phase may render decision necessary which bear certain resemblance to the procurement process, the European legislator has neglected it. However, as an increasing number of PPPs enter the post-award phase, it is submitted that the issues involved deserve clarification.

From the example of seven legal uncertainties in PFI procurement it is possible to conclude that it may become necessary to re-evaluate and clarify procurement law in some areas to increase its impact on the PFI practice. In not amending the existing body of law and in not clarifying its applicability to PPPs, the European legislator failed to echo the emergence of those exceptionally complex procurement tasks. This failure negatively influenced the impact procurement law on PFI procurement to an extent that practitioners perceived the legal framework in certain areas as “unworkable” and causing unnecessary legal uncertainties.

It is submitted that the impracticability of procurement law, which may have partly resulted from the lack of re-evaluation, substantially affected its impact on PFI procurement practice.

12.4.1.4. Findings

Adopting an outsider perspective, we have analysed two relevant conditions for making an impact on its social context so far, namely the existence of competing rules

¹⁰⁰ COM(89) 380 final.

and values, and constant re-evaluation of the law. On the other hand it was held that the way the Directives were implemented into national law did not affect their impact on the legal practice. The sections have shown that none of the conditions for law to make an impact on a legal practice was satisfied or completely satisfied. It is possible to conclude from an outsider perspective that procurement law has had only a limited impact on PFI practice, meaning the law was not capable to fulfil its function of influencing the behaviour of its addressees.

12.4.2. Impact of the rules on the practice from an insider perspective

Having discussed the outsider perspective of impact of the rules, it becomes necessary to consider the perspective of insiders to gain a complete picture. PFI practitioners frequently mentioned that PFI procurement practice failed to conform with a strict interpretation of public procurement law.¹⁰¹ Although not many respondents endorsed the provocative thesis that rules and practice were “fundamentally incompatible,” they concurred that “it is difficult to have them fit comfortably.”¹⁰² PubSA#9 boiled it down to a “conflict of policies.” She added “the aim of transparent procurement market in Europe stands against letting projects happen and not burying them in red tape.”¹⁰³ PubSA#5 agreed that the rules were “not accommodating the commercial reality of a PFI project.”¹⁰⁴

As evidence for this perception, lawyers gave the example that rules and structures of procurement law do not allow for the level of negotiations required.¹⁰⁵ The Directives' rigidity made authorities think about whether it was possible for them to comply with the principles underlying the procurement Directives instead, such as non-discrimination, fair and transparent procedures, and competition.¹⁰⁶ PubSA#2 observed their public sector clients had to comply not only with the procurement rules

¹⁰¹ PrivSA#1; PubSA#4.

¹⁰² PubSA#3; PrivSA#3.

¹⁰³ PubSA#9.

¹⁰⁴ PrivSA#6.

¹⁰⁵ For example: PubSA#3.

¹⁰⁶ PubSA#3.

but also with the documentation issued by sector-specific government departments, such as the NHS Executive, and by the Treasury Taskforce. Guidance notes were “most of the time compatible with the broad principles of the procurement rules, but not with the detailed rules.” PubSA#2 said this matter caused “a bit of a problem on the interface.” Apart from compliance issues, public sector clients sought to use procurement law “to get the best bids in and to achieve the best result possible.”¹⁰⁷

Another aspect mentioned with respect to the relationship between rules and practice was that the procurement procedures were drawn up when PFI was not invented.¹⁰⁸ PrivSA#2 argued that there were “perfectly sound reasons for wanting to get outside these rigid procedures, although it’s very difficult.” PubSA#4 suggested that

“the rules are something of a blunt instrument and the draftsmen had in mind fairly straight forward projects and not complex procurement tasks such as PFI.”

Recently, the Commission published its proposals for amending the rules to accommodate PPP projects more comfortably. PubSAs#2 and PubSA#3 were dismayed by the proposals because they still not provided their public sector clients with sufficient room for manoeuvre.¹⁰⁹ Many doubted whether it was possible to establish a set of rules for complex procurement tasks such as PFI and PrivSA#1 concluded

“we should rather drag the rules to the practice than the practice to the rules.”

¹⁰⁷ PubSA#2.

¹⁰⁸ PrivSA#2.

¹⁰⁹ BothSA#1.

12.5. Risks arising from the conflict between rules and practice

Section 12.5. will explore the risks arising for authorities from the conflict between the law in the books and the legal practice. The discussion will combine the insider perception with the perspective of an outsider to PFI procurement practice.

Risks for the authority could mainly arise if a strict interpretation of the law in the books was effectively enforced. We have seen in section 3.3.2.3. that there are two main methods to enforce procurement law within the European Union. The law is firstly enforced by bidders in national courts and section 12.5.1. will deal with the national enforcement practice.

Secondly, the European Commission enforces European procurement law.¹¹⁰ Section 12.5.2 will assess the risks arising from Article 226 E.C. Treaty proceedings from the perspective of an outsider and an insider to PFI procurement practice. A lack of enforcement by either method could seriously limit the impact of procurement law on the PFI practice. Diligent enforcement is, hence, the fourth potentially relevant pre-condition for law having a significant impact.

Section 12.5.3. will then explore from the outsider perspective the last of the five potentially relevant pre-conditions for the law to make an impact, namely the need for benefits to outweigh the costs of compliance. From an outsider perspective, it appears questionable whether this has always been the case in PFI procurement.

12.5.1. National enforcement practice

The first leg of the twofold remedy system in European procurement law is based on the assumption that disgruntled bidders are interested in pursuing their rights in national courts.¹¹¹ This approach implies that if bidders are for whatever reasons not committed to enforce procurement issues, the law remains unenforced with the

¹¹⁰ For an overview on remedies in procurement law: Arrowsmith, op.cit., note 2, ch.18; Arrowsmith, op.cit., note 98 of ch.3; Öhler, *Rechtsschutz bei der Vergabe öffentlicher Aufträge in der Europäischen Union* (1997); Tyrell/Bedford, *Public Procurement in Europe: Enforcement and Remedies* (1997).

¹¹¹ Arrowsmith/Linarelli/Wallace, op.cit., note 63 of ch.5, p.751: “The parties most likely to initiate review procedures are, of course, firms ...”

exception of significant cases which are dealt with by the Commission. Not only in PFI but also in other areas of government procurement in the U.K., there has been an apparent lack of cases brought forward by bidders.

On the other hand, contracting authorities on the continent currently face a wave of litigation on procurement tasks, which are smaller and less complex than PFI. It may therefore be that in the U.K. the assumption that bidders are committed to challenging authorities on procurement matters is flawed for a variety of reasons which are worth exploring in detail.

Section 12.5.1.1. will firstly discuss from an outsider perspective whether the remedies for enforcing procurement law are adequate. Turning to the insider perspective, section 12.5.1.2. will then address how practitioners assessed the adequacy of the U.K. remedies system and the risks posed by disgruntled bidders employing it. Was the risk arising from the remedies suffice to influence the conduct of authorities? On the other hand, if bidders chose not to use the remedies system made available to them by the procurement Regulations, the motives underlying the decision deserve a closer examination. Those motives, which include the legal culture in the U.K. and a commercial approach to winning public contracts, will be discussed in section 12.5.1.3. to 12.5.1.6 by adopting the perspectives of participants in the practice.

In order to answer the question why bidders did not bring challenges, the sample included lawyers advising private sector bidders on whether to pursue their interests in PFIs by means of procurement law remedies. Both, the public and private sector analysed the pros and cons of challenging a PFI procuring authority. Whilst the private sector was interested in exploring the chances of effective remedies available to them, the public sector was interested in gaining insights into the risks of being challenged on a specific decision adopted in the course of the procurement process.

12.5.1.1. U.K. remedies system from an outsider perspective

One reason why bidders did not employ remedies may be the review system itself. The following section will examine the U.K. remedies system from an outsider perspective.

It is advocated that diligent and effective enforcement is the third major precondition for law having a significant impact. It is generally recognised that persons and institutions responsible for enforcing the law must be fully committed¹¹² to their task.¹¹³ This entails that the addressees of the norms should be aware of the possibility that any deviating behaviour is likely to result in being challenged and prepared to change their behaviour, as appropriate, to bring it into line with the law.

The U.K. provides neither a central enforcement authority nor a national review body for enforcing procurement law.¹¹⁴ In contrast to the implementation of the material procurement Directives, the implementation of the Remedies Directive in the U.K. has been criticised for deterring providers from launching proceedings against procuring authorities.¹¹⁵

Especially the difficulties to obtain interim measures¹¹⁶ under the U.K. system have been subjected to criticism.¹¹⁷ English courts were traditionally reluctant in the past to grant interim measures. This tradition stands in contrast to the requirement of *rapid* review arising from the European Directives. However, in the *Harmon* case,

¹¹² Colombotos, "Physicians and Medicare: A Before-After Study of the Effects of Legislation on Attitudes" (1969) *American Sociological Review*, p.321; Dixon, *From Prohibition to Regulation: Bookmaking, Anti-Gambling, and the Law* (1991), ch.7.

¹¹³ Evan, *The Sociology of Law: A Social-Structural Perspective* (1980), rephrased in: Cotterrell, op.cit., note 6 of ch.4, p.59.

¹¹⁴ For an overview see: Arrowsmith, op.cit., note 98 of ch.3.

¹¹⁵ Arrowsmith, "Enforcing the EC Procurement Rules: the remedies system in England and Wales" (1992) *P.P.L.R.* p. 92; Weatherill, "Enforcing the Public Procurement Rules in the United Kingdom", chapter 8 in: Arrowsmith (ed.) op.cit., note 98 of ch.3, (1993); Tyrell/Bedford, *Public Procurement in Europe: Enforcement and Remedies* (1997).

¹¹⁶ Works Reg. 31(5)(a); Supply Reg. 29(5)(a); Services Reg. 32(6)(a); Utilities Reg. 32(5)(a).

¹¹⁷ EuroStrategy Consultants, op.cit., note 8 of ch.1, para 8.2.1.

judge Humphrey Lloyd Q.C. was prepared to give a greater weight to the interest of the challenging bidder when balanced against public inconvenience.¹¹⁸

The second remedy, the setting aside of an unlawfully adopted decision or action¹¹⁹ is *de facto* not available to bidders. As contracts will be generally concluded when the proceedings are launched and project agreements cannot be set aside and the only remedy *de facto* available to bidders are damages. If a court should decide to award damages, it is uncertain under the U.K. remedies system how to calculate or assess them.¹²⁰ In the *Harmon* case, Humphrey Lloyd Q.C. held that all lost profits can be recovered if the bidder would have won the contract. Where this does not apply, he held that the bidder could recover a certain percentage of the lost profits based on the percentage of the chance of winning the contract, provided the chance was substantial.¹²¹ Irrespective of which remedy is chosen, the costs in the form of legal expenses and management costs and the time involved in bringing actions on procurement issues before the High Court¹²² seems to be a major deterrence for bidders from employing the U.K. remedy system more frequently.

It can be concluded from an outsider perspective that the implementation of the remedies Directives in the U.K.¹²³ resulted in a remedy system which appears difficult to use.¹²⁴ The highlighted inadequacies may encourage behaviour of authorities which is irreconcilable with a strict interpretation of procurement law and, hence, limit its impact.

¹¹⁸ Arrowsmith, "E.C. Procurement Rules in the U.K. Courts: An Analysis of the Harmon Case" (2000) *P.P.L.R.* pp.120-134; pp.135-145.

¹¹⁹ Works Reg. 31(6)(b)(i); Supply Reg. 29(5)(b)(i); Services Reg. 32(5)(b)(i); Utilities Reg. 32(5)(b)(i).

¹²⁰ Arrowsmith, op.cit., note 2 of ch.1, pp. 892 et seq., 911 et seq.

¹²¹ *Harmon CFEM Facades (U.K.) Ltd v The Corporate Officer of the House of Commons*, High Court; judgment of 28 October 1999.

¹²² Works Reg. 31(4); Supply Reg.(29)(4)(b); Services Reg. 31(4)(b); Utilities Reg. 32(3).

¹²³ BothSA#1.

¹²⁴ Though there have been two recent cases on general procurement law issues: *Clyde Solway v The Scottish Ministers*, Inner House, Court of Sessions, judgment of 22 January 2001 (unreported); *Jobsin Internet Services v Department of Health*, High Court, judgment of 18 May 2001 (unreported).

12.5.1.2. U.K. remedies system from an insider perspective

Viewed from an insider perspective, all lawyers remarked that risks arising from either disgruntled bidders or the Commission were monitored and assessed throughout the PFI procurement process though the degree of caution and risk awareness varied.

In practice, legal advice on the analysis of risks is provided in different ways. Public sector advisors said that public sector clients request advice on this issue, since the risk assessment can be deemed as being one of the more difficult questions of the procurement process.¹²⁵ Whilst the majority of respondents outline the procedural options available to their clients and recommend the adoption of one alternative,¹²⁶ PubSA#7 rejected this practice and said that she suggested only one solution to her clients. The assessment of the risks involved in each approach is the decisive consideration to decide which of the procedural options is implemented. One of the risks constantly assessed before adopting decisions is the question of whether either the Commission or an aggrieved bidder could challenge the authority.

PubSA#4 said the general perception of public sector authorities was that bidders were not prepared to challenge them. This was the reason why the litigation risk in PFI was regularly considered negligible.¹²⁷ Lawyers were very much aware of the legal problems involved in following governmental guidance and the risks arising from this approach. They nevertheless opted for “pragmatic” decisions. BothSA#3 said

*“a lot of the advice even from Queen’s Counsels has been that there is hardly any downside: if you breach the rules, so what?”*¹²⁸

The complacency shown by the public sector and its advisors is surprising given their awareness that “we have illegality leaning over us all the time.”¹²⁹ The findings sharply contradict the assumption of the European legislator that consortia bidding for

¹²⁵ PubSA#3, PubSA#9, PubSA#10, BothSA#5, BothSA#6.

¹²⁶ For example: PubSA#3.

¹²⁷ PubSA#4: The risk of being challenged by contractors is considered to be fairly minimal.

¹²⁸ BothSA#3.

¹²⁹ BothSA#3.

PFI projects were interested in challenging authorities, because of the considerable sums private firms spend on preparing bids and the lucrative profit margins at stake.

One of the reasons for the apparent unwillingness of bidders to challenge was, on the word of PubSA#9, that “going to the High Court in the U.K. is quite off-putting.” BothSA#1 added the U.K. tradition of public procurement legislation was still in its infancy. The system required time to sink into the minds of private companies. BothSA#1 agreed the remedy system was dysfunctional due to the implementation of the Remedies Directive in the U.K. In particular, the U.K. lacked a central enforcement authority to which bidders could complain. This was the main reason why authorities were not complying with the letter of the procurement rules or with a literal interpretation of the rules. He did not think that this was a disadvantage, either for the authority or for the private sector nor for the system as a whole.¹³⁰

Probably the most significant deterrent to using the remedy processes lawyers mentioned were the legal costs involved in launching proceedings against contracting authorities.¹³¹ High Court proceedings in the U.K. were extremely costly and could easily consume the profit margin the company expected to gain from the project. The costs of using remedies against procurement decisions comprised the “quite phenomenal”¹³² legal costs¹³³ and the management costs on the side of the company. Even if the company was prepared to spend money on litigating against the authority, it was uncertain whether it would be able to recover its legal expenses and the profits lost. There was no guarantee that the company would win the case. PubSA#4 suggested that bidders would only take costly legal action when “there is a cheque at the end of it.”

The lack of precedent cases makes it difficult to predict the outcome of challenges based on procurement law and it is almost impossible for lawyers to advise

¹³⁰ BothSA#1.

¹³¹ Many, PrivSA#2, BothSA#6.

¹³² PubSA#4.

¹³³ PrivSA#2.

their private sector clients on whether they will be awarded damages. What is more, if winning would be guaranteed to aggrieved bidders, the public sector side would certainly try to reach a settlement outside the courtroom. These uncertainties, partly due to the lack of case law, combined with the high costs of bringing challenges proves to be an efficient deterrent to bidders in the U.K. to pursue their claims in the courts.

The difficulty of proving that the bidder would have won the contract was described to be an even greater deterrent to challenge authorities. To assess this question, the bidder had to have a detailed knowledge of the bids submitted by their competitors. Lawyers maintained that this knowledge was generally not available to their private sector clients.¹³⁴ PrivSA#2 remarked that if the company was not amongst the frontrunners to win the contract and its prices were in the middle of the range, it would be reluctant to instigate a complaint going beyond an exchange of letters.¹³⁵ According to their legal advisors, bidders said “it is not fair,”¹³⁶ but took “it on the chin”¹³⁷ and hoped “to get the next one”¹³⁸ and did not want to “antagonising everybody.”¹³⁹

From a public sector perspective, one can conclude that the U.K. remedy system poses a variety of hurdles to its utilisation. It seems that the way in which the U.K. implemented the Remedies Directives deters even those contractors from using remedies which contemplate the possibility to challenge authorities. Therefore, a typical risk assessment of a PFI awarding authority will generally conclude that private sector bidders are unlikely to challenge decisions adopted in the course of the

¹³⁴ Many, for instance BothSA#2, BothSA#6.

¹³⁵ PrivSA#2.

¹³⁶ PrivSA#2.

¹³⁷ Many, PubSA#8.

¹³⁸ Many.

¹³⁹ PrivSA#2.

procurement process. British contractors have become participants in the PFI procurement practice and have no interest to threaten the “fragile house of cards.”¹⁴⁰

PrivSA#3 mentioned the fragile house of cards could only collapse if an outsider to the practice commenced review proceedings. Outsiders were only likely to challenge the practice if the considerations which U.K. bidders took into account were not applicable. This applied in particular to situations where an authority awarded a unique project offering high returns on investments.

It can be concluded from this section that insiders to PFI procurement share the outsider analysis of the U.K. enforcement system of procurement law in describing it as only of limited effectiveness. Bidders for PFI contracts are not willing to challenge their “clients.” It is submitted that the lack in diligent enforcement lead to the widespread perception of public sector authorities that they “get away with everything” because “who is going to challenge [them] anyway?”¹⁴¹ This persuasion seems to significantly compromise the impact of the procurement law on the legal practice and deprive procurement law from having a more significant impact in the U.K.

12.5.1.3. U.K. “legal culture”

Apart from the inaccessible remedies system, lawyers frequently mentioned that it was incompatible with the U.K. “legal culture” to challenge authorities on procurement issues. The following section will explore in greater detail from an insider perspective what practitioners meant by using this term. It will suggest a number of more precise factors deterring bidders from employing the remedies. These factors can be summarised as the young tradition of procurement remedies in the U.K., a general fear of being blacklisted, the prevalence of amicable means to settle disputes and a vested interest of the bidders to maintain the status quo.

¹⁴⁰ PrivSA#3.

¹⁴¹ PubSA#3.

When asked why there was hardly any litigation on procurement issues in the U.K., lawyers firstly argued that other European countries had a longer tradition of procurement legislation. PubSA#9 said bidders in countries such as Belgium were more used to employ remedies. She assumed that, as with any other “changes in culture,” it would presumably take some time to change the approach taken by U.K. contractors. PubSA#4 remarked that such a change in culture would be neither recognisable at the moment nor desirable in the future. PrivSA#2 was “amazed that nobody has challenged authorities” but he did not have “a client who asked me to. I spoke to the senior in-house solicitors of two or three big construction clients and asked them ‘have you ever thought about it?’ No they have never thought about it.”¹⁴²

Not only do contractors and their legal advisors have to get used to the availability of formal remedy procedures in public procurement; the same applies to the courts. BothSA#6 characterised the U.K. courts as “helpless in applying EU law in general and public procurement law in particular.” Whether this assessment reflects the situation reasonably or not is difficult to establish. Nevertheless, it can be concluded from the absence of any substantial case law that U.K. courts apparently lack experience in enforcing procurement law, especially when compared with their continental counterparts.

The second reason mentioned for not suing public authorities over their procurement practices was that bidders feared they would be blacklisted.¹⁴³ BothSA#3 remarked that “there is no evidence but there is rumour that certain departments operate a *de facto* blacklist, like health and if you are on the blacklist you don’t get any jobs.” It is astounding that lawyers mentioned blacklists so frequently and yet none of them could give any hard evidence of cases where a contractor has not been considered because of such a list. Probably, the concern of being blacklisted reflects

¹⁴² PrivSA#2.

¹⁴³ PrivSA#2, PrivSA#3, PubSA#4, and many more.

the general desire of firms not to dent their reputation in crowded PFI markets.¹⁴⁴ It may be for this reason that “people rather take it [meaning a dubious procurement decision] on the chin”¹⁴⁵ than challenging potentially wrongful decisions in the courts.

On the other hand, PubSA#9 said it was becoming less of a commercial suicide to challenge authorities now and there was a greater acceptance in the market that the rules had to be complied with. This did not amount to a change in the general legal culture not to challenge decisions of awarding authorities, but people “know more now, what increases the risk.” Although the rules had been “around for some time” PubSA#9 observed that could not recognise “a massive upswing of procurement litigation.”

Lawyers mentioned as third reason for not employing the remedies system that the amicable settlement of disputes was an important part of the legal culture in the U.K. Disgruntled bidders were said to favour indirect and informal approaches to pursue their interests in the contract award procedure. PrivSA#3 remarked actions against procurement decisions were generally limited to an exchange of letters.¹⁴⁶ Bidders thereby requested more detailed more information on specific questions, such as the interpretation of the selection and award criteria.¹⁴⁷ Especially in high-profile projects, private sector advisors said they “stirred up” the authority by indirect means. Those means included to contact superior bodies or to leak information to the local or national press. BothSA#1 reported he contacted persons within the Treasury or the superior government department on specific issues asking them to apply pressure on the PFI awarding authority.¹⁴⁸ He and other lawyers¹⁴⁹ characterised indirect ways for looking after the interests of his clients as a cost and time effective way¹⁵⁰ to re-open

¹⁴⁴ PubSA#1.

¹⁴⁵ BothSA#3.

¹⁴⁶ Many, such as PrivSA#3.

¹⁴⁷ PubSA#3.

¹⁴⁸ BothSA#1.

¹⁴⁹ PubSA#3.

¹⁵⁰ BothSA#1.

discussions with the authority and to complain about procedural issues in general.

PrivSA#5 added

“what is there to be gained out of the challenge? The market players want to see a financial benefit and don’t see it as an academic exercise.”¹⁵¹

It can be inferred from the above that bidders assume their interests are better served by employing informal and indirect ways to influence decisions made in the award process rather than by launching formal proceedings against the authority.

The final element of a legal culture, which emerged in the interviews, is the vested interest of bidders not to question the status quo. To say it in the words of BothSA#1, who acted predominantly for the private sector,

“not complying literally with the procurement rules or with a literal interpretation of the rules is not a disadvantage neither for the authority nor for the private sector nor for the system as a whole.”¹⁵²

Other private sector legal advisors reported their clients were not interested in challenging authorities on issues such as the unjustified use of the negotiated procedure. The effect of such a challenge could be that a court ruling restricted this practice substantially. This outcome would certainly not be in the interest of the complainant. PrivSA#2 remarked: “we don’t want to make the law in the domestic courts to the effect that this (meaning PFI procurement practice) is not permissible.”¹⁵³ Another possibility would be that the complainant had to face a similar challenge brought by a competitor in another PFI project, where the complainant had good chances of securing the contract. The effect was

¹⁵¹ PrivSA#5.

¹⁵² BothSA#1.

¹⁵³ PrivSA#2.

reinforced where only a limited number of contractors existed in the market. In this situation, none of the contractors wanted “to be the one who starts challenging.”¹⁵⁴

For the reasons mentioned, bidders are interested to keep the status quo and to avoid “shooting themselves in the foot.”¹⁵⁵ PrivSA#6 speculated that the status quo was based on the assumption that each market player was “getting a fair share” of the projects available. With a view to the multitude of PFI contracts advertised, the attitude of contractors failing to secure a contract is to “hope that they will get involved in the next one that comes along.”¹⁵⁶ That means in turn that in unique projects, such as London Underground, the risk of challenges is much higher. In those projects the chance of a follow up contract is low whilst the risks and rewards of the projects are very high. On the other hand, in the road or hospital area, where a commodity product has been developed, the risks of challenges are lower because the market has matured.¹⁵⁷

PrivSA#6 remarked

“none of the big players would upset the non-aggression arrangement that currently seems to exist.”¹⁵⁸

Using the military term “non-aggressive arrangement” in the context of a competitive contract award process appears odd. Procurement law is based on the assumption that contracts are awarded in a competitive (“aggressive”) manner and that aggrieved bidders (“aggressively”) enforce the rules. Conversely, the statement indicates the existence of a mutually beneficial understanding not only between public and private sector but also among private sector firms which compete for PFI

¹⁵⁴ PrivSA#6: “You see the same names cropping up repeatedly in terms of consortia who are bidding in the various sectors of PFI.”

¹⁵⁵ PrivSA#6.

¹⁵⁶ Many, inter alia PrivSA#6.

¹⁵⁷ PrivSA#6.

¹⁵⁸ PrivSA#6.

contracts not to launch challenges. It seems feasible that this understanding amongst market players prevents procurement law from being effectively enforced given that bid challenges of disgruntled tenderers are the main technique of enforcement.

“Outsiders” to the practice might be interested in a specific PFI project and do not have vested interests in preserving the status quo, such as foreign bidders. Legal advisors were doubtful whether the involvement of foreign bidders in the PFI bidding process would increase the risk of challenges. They were confident that foreign bidders would have to enter into joint ventures with British firms so that “British business practices are likely to prevail.”¹⁵⁹

In addition, foreign bidders were likely to require legal advice from U.K. lawyers who would recommend the same litigation strategy to their domestic and their foreign clients. Equally, foreign bidders would face the same problems in employing the U.K. remedies procedures: “the cost and time involved in using the U.K. remedies system will put even those firms off, which are used to sue their home state. Foreign bidders want to stay in the U.K. market and have no interest in being identified as troublemakers.”¹⁶⁰ Other lawyers also suggested the considerations of U.K. firms, such as possible blacklisting or the adoption of a portfolio approach were also applicable to foreign bidders which sought to enter the U.K. market.¹⁶¹

12.5.1.4. Role of legal advisors

Another reason why contractors do not challenge PFI awarding authorities is the reluctance of their lawyers to advise them to do so. There are some indications from an insider perspective that the competitively negotiated contractual arrangements between legal advisors and their clients do not encourage bringing challenges. PubSA#1 mentioned clients would have pre-arranged legal contracts with a fixed sum which were aimed at getting the

¹⁵⁹ BothSA#1.

¹⁶⁰ BothSA#1.

¹⁶¹ PubSA#7.

contract closed. Hence, lawyers had no interest in spending too much time on one case. Otherwise, the tight margins did not allow a full recovery of the costs incurred.¹⁶² In the early days, law firms even accepted to incur losses on PFI projects to get a share of the competitive market for legal advice in PFI.

12.5.1.5. No reason to bring challenges

When asked why companies did not challenge authorities on procurement issues, some lawyers bluntly replied that “our system works” and “that the rules are fairly well applied in Britain.”¹⁶³ PrivSA#3 remarked from an insider perspective there had been “quite a lot of work done: the Treasury Taskforce has published guidance notes and the NAO monitors the whole process.”¹⁶⁴ Local authorities and certain central government departments in the U.K. were aware of the problems involved and were cautious to apply rules properly to ensure that there was nothing wrong.¹⁶⁵

Other lawyers made similar statements, especially legal advisors to the public sector. It is submitted that by referring to the Treasury and other sector specific guidance as the rules which have to be complied with, those lawyers probably underestimated the divergence of the government guidance from procurement law.¹⁶⁶ These statements are an interesting account of the lawyers’ perception of the Treasury guidance. However, they do not answer the question of whether bidders have not had reasons for bringing challenges.

12.5.1.6. Commercial approach to winning public contracts

Probably the most important reasons for private sector companies not to challenge an authority over irregularities in PFI procurement are of commercial

¹⁶² PubSA#1.

¹⁶³ PrivSA#3.

¹⁶⁴ PrivSA#3.

¹⁶⁵ PrivSA#3.

¹⁶⁶ See for example the diverging views on the use of the negotiated procedure, chapter 7.

nature. Those reasons will be highlighted in the following section from an insider viewpoint. This is mainly because managers of private firms focus on commercial considerations. PrivSA#6 observed that “the fact that there are no challenges is not driven from the legality of the process or any legal problems, but merely by commercial decisions.”¹⁶⁷ It is feasible to break down the most mentioned commercial considerations into three categories, namely access to markets, portfolio approach and management priorities.

One of the primary commercially oriented reasons why companies try to stay out of courts is the widespread attitude that public sector authorities are invaluable clients. Challenging their decision could have a negative impact on the access to the public procurement market. PrivSA#2 said that even if a company had a good case for suing over procedural irregularities, it would not do so “because you don’t bite the hand that feeds.”¹⁶⁸ PubSA#4 commented challenging the authority was not compatible with the private sector’s perception of a good relationship between a client and its service providers. The only legal challenge related to PFI, the *Pimlico* case, confirms this perception. The persons who filed the complaint in this case with the commission “were not parties to the procurement process, but members of the local community, who sought to squash the whole concept of having run education by the private sector. It is more likely that such pressure groups pick on irregularities than the bidders.”¹⁶⁹

Another commercial reason for not suing authorities is that many commercial entities bidding for PFI projects adopted a portfolio approach. PrivSA#6 maintained that this business strategy implied that firms sought to secure several contracts in a specific PFI sector.¹⁷⁰ This approach offered the opportunity to achieve synergies by grouping those projects once they have entered the operation phase. The portfolio approach requires a repeat product, that is a similar type of PFI project with similar

¹⁶⁷ PrivSA#6.

¹⁶⁸ PubSA#4.

¹⁶⁹ PubSA#4.

¹⁷⁰ PrivSA#6.

contractual and financial terms. PrivSA#4 observed that it was common understanding among private sector firms to pursue such an approach. According to the understanding of his clients, it was detrimental to challenge a government department which was likely to offer other opportunities that could fit into the portfolio.¹⁷¹

As the decision over whether to sue the authority or not is commercial in nature, companies are said to consciously weigh the commercial advantages and disadvantages of such an action. It is a matter of commercial judgment and management priorities for them to decide whether litigation serves their interests or not. Lawyers, as the participants in the study play an essential role in analysing the likelihood of winning cases on procurement issues for their private sector clients. The advice will usually comprise the important question of whether the bidder is entitled to damages and whether the damages would include a recovery of the lost profits.

PrivSA#2 and PubSA#9 observed the current mind-set in the industry was that instead of facing problems in calculating their loss of a chance and the damages they could sue for, they rather sought to secure future contracts. Companies were more interested in doing business and positioning themselves for future businesses. They tried to “win the next one”¹⁷² or, if they were in the middle of the procurement process, they sought to “win the competition rather than complaining about some procedural irregularities.”¹⁷³ PrivSA#5 and PrivSA#6 mentioned that the commercial judgement also included the consideration that if their clients challenged the procedures in relation to a project, they could find themselves at the receiving end at a similar challenge from somebody else on another project. A wave of litigation and the related delays to PFI projects caused was not in the commercial interests of regularly companies bidding in PFI competitions.

¹⁷¹ PubSA#4, PubSA#4.

¹⁷² PubSA#9.

¹⁷³ PubSA#8.

12.5.2. Enforcement practice of the European Commission

The enforcement of public procurement law in Europe secondly relies on the European Commission launching Article 226 E.C. Treaty proceedings against Member States. Section 12.5.2. will first highlight the outsider perspective of the enforcement practice before turning to its perception by practitioners.

From an outsider perspective it can be firstly held that it may be difficult for a national legislative body to sustain an effective threat of enforcement. It is even more complicated for the supra-national European Community to achieve a satisfactory level of enforcement.¹⁷⁴ The reasons for supra-national law being difficult to enforce are manifold.¹⁷⁵ The most obvious may briefly be mentioned.

First, the Commission, as part of the legislative body, is not responsible for the execution of its policies, which is in most areas transferred to national authorities. But, the national authorities responsible for implementing the supra-national law may pursue interests diverting from those of the supra-national legislator.¹⁷⁶ Even if the national enforcement agencies perceive the purposes of the supra-national law as compatible with national interests, there is potential for misinterpretation and misapplication of the law. In the context of PFI procurement, H.M. Treasury, as the national authority responsible for implementing European procurement law into national U.K. law, has issued guidance notes which deviate substantially from the interpretation suggested by the Commission and the Court of Justice.

Secondly, due to the sheer size of the Community and the complexity of its rules, the Commission is unable to monitor compliance in every sector. This development decreases the scope for central enforcement. Enforcement actions become dependent on the infringement of individual interests and the motivation either to challenge the

¹⁷⁴ Swart, op.cit., note 99 of ch.3, p.1.

¹⁷⁵ See for a more detailed analysis: Harding/Swart (eds.), op.cit., note 99 of ch.3; Vervaele, *Compliance and Enforcement of European Community Law* (1999).

¹⁷⁶ Snyder, note 6 of ch.1, p.24 et.seq.

infringement in the courts or to complain to the Commission.¹⁷⁷ In general, the latter generally limits its enforcement activities under Article 226 E.C. Treaty to systematic and momentous breaches of the procurement rules and stressed that “conflicts are to be settled primarily at national level.”¹⁷⁸

One example of a “manifest” breach of the rules was, according to the Commission, the systematic reliance of PFI awarding authorities on the negotiated procedure. The Guardian of the Treaty held that its application was not justified by the circumstances and decided to send a reasoned opinion to the U.K.¹⁷⁹ In commencing infringement proceedings on this ground against the U.K., the Commission demonstrated its commitment to enforce its interpretation of procurement law. As the reasoned opinion is addressed to the Member State, it is noteworthy that it has no immediate effect on the authority or the PFI under consideration. The Commission may only contact purchasers directly and ask them to respond within 21 days.¹⁸⁰ Ultimately, the infringement procedure could result in a judgment of the European Court of Justice which may interpret the rule in a manner inconsistent with the approach encouraged by U.K. authorities.¹⁸¹ From an outsider perspective, the deterrence arising from Article 226 actions can be therefore described as low.

Though generally committed to enforce major breaches of Community procurement law, it has taken the Commission nine years since the adoption of the PFI scheme and a complaint from private persons to enforce its interpretation of procurement law in PFI. Hence, despite a general commitment to enforce systematic breaches of procurement law, the Commission’s enforcement will remain patchy and dependent on third parties drawing its attention to specific issues. The patchiness of the Commission’s enforcement action is, from an outsider perspective, mainly due to a

¹⁷⁷ Swart, op.cit., note 99 of ch.3, p.1.

¹⁷⁸ European Commission, *European Procurement Brochure “The rules governing the procedure in the award of Public Procurement Contract”* (2000).

¹⁷⁹ “Pimlico case,” cf. European Commission, (2000) *Single Market News* No.23 (October).

¹⁸⁰ Arrowsmith (ed.), op.cit., note 24 of ch.2, para 7.041.

¹⁸¹ See above section 3.3.2.3.

lack of resources. In cases where the PFI project receives a financial contribution from a Community institution, including the European Investment Bank, non-compliance with the procurement rules may result in the Community institutions withdrawing the funding.¹⁸²

Turning, secondly, to the insider perception of the enforcement practice of the European Commission it can be held that practitioners either largely underestimated¹⁸³ or ignored the risk that the Commission could challenge procurement decisions. It is for this reason that the issuing of a reasoned opinion against the United Kingdom in the *Pimlico* case in the year 2000 surprised many lawyers. However, it is noteworthy that respondents with an EU Law or a Competition Law background were less surprised by the action taken.¹⁸⁴ PubSA#4 said:

“I thought that the Commission wasn’t posing a huge risk as well, but after their recent intervention, I should be probably a bit more nervous.”

Practitioners who knew the *Pimlico* case said they were more worried about the possible impact of the reasoned opinion issued by the Commission against the United Kingdom than about possible challenges from bidders.¹⁸⁵ This goes in particular, since legal advisors said they had largely underestimated the risk arising from the Commission and possible challenges in an Article 226 E.C. Treaty proceedings.¹⁸⁶ BothSA#3 characterised the reasoned opinion as “a wrong message.” He thought that the reasoned opinion in the *Pimlico* case could collapse the fragile house of cards, the PFI procurement practice. It was undisputed amongst lawyers that the Commission challenged one of the main cornerstones of the PFI procurement practice. BothSA#3 said PFI would be very hard to do without using the negotiated procedure.¹⁸⁷ As we

¹⁸² Arrowsmith (ed.), op.cit., note 24 of ch.2, para 7.045.

¹⁸³ PubSA#4.

¹⁸⁴ BothSA#5; BothSA#6.

¹⁸⁵ BothSA#3, BothSA#6.

¹⁸⁶ PubSA#4

¹⁸⁷ BothSA#3.

have seen in chapter 3, the Article 226 E.C. Treaty action is not suitable to challenge specific projects but is directed against the Member State, here the United Kingdom. On the other hand, project lenders are presumably reluctant to cover any risks arising from not complying with procurement law in the form of an ECJ judgment. It is therefore submitted with PubSA#8 that a judgment that finds the regular use of the negotiated procedure in PFI not compatible with procurement law would have an immediate impact on PFI procurement practice. The reasoned opinion was too recent and the outcome too uncertain for lawyers to render conclusive judgements on whether it could affect the risk assessment of authorities or, on a larger scale, the PFI procurement practice.

Viewing the case together with the disappointing proposals to reform procurement law published by the Commission in September 2000, lawyers had the impression that Brussels “sends out wrong signals”¹⁸⁸ based on a fundamental misapprehension “of what we are doing.” When compared with the risk arising from aggrieved bidders, PrivSA#6 perceived that it was

*“more likely that the Commission would intervene than one of the big players.”*¹⁸⁹

Interviewees did not mention the risks posed by a possible withdrawal of Community funds in case a public sector client did not strictly complying with procurement law or adopted risky procedural decisions.

12.5.3. Weighing the pros and cons of a procedural decision

The last of the five potentially relevant conditions for law to make an impact is, from an outsider perspective, that the benefits arising from compliance have to outweigh the benefits of non-compliance. This hypothesis is based on the “general principle of human psychology”¹⁹⁰ that the degree of compliance with the law is the

¹⁸⁸ BothSA#3.

¹⁸⁹ PrivSA#6.

¹⁹⁰ Lustgarten, “Racial Inequality and the Limits of Law” (1986) *Modern Law Review*, pp.79.

higher, the more the addressee reckons with a negative sanction (deterrence). For the remedy to be deterrent, the detriment which the contracting authority may suffer as a result from the non-compliance (D) must exceed the benefit which it will derive from the conduct (B). In the case of public authorities, the detriment D does not only include the financial loss caused by damages or the time slippage of the project, but also the potential stigma involved in the remedy process, such as bad press. The uncertainty over whether any bidder lodges a remedy procedure requires that D must be discounted to reflect the probability (p) of the detriment being incurred.¹⁹¹ Hence, for the remedy to be effective, the legislator must seek to ensure that $pD > B$.¹⁹² When the benefits (B) exceed the detriments (D) discounted by the probability of the sanction (p), deviating from the law may be beneficial for the addressee. The expected benefits from not complying with the law are a “driving force” motivating the deviating behaviour.¹⁹³ In complex legal situations where one decision may trigger a multitude of positive and negative consequences, addressees will carefully weigh the expected consequences and assess them commercially.

The findings gained by adopting an outsider perspective were supported by several respondents. They said authorities usually weighed the benefits and risks arising from adopting certain procedural decisions in the form of a risk assessment.¹⁹⁴ PubSA#9 pointed out that the assessment especially considered the characteristics of the individual project and the market.¹⁹⁵ To analyse the deterrence arising from the procurement Directives, especially the remedies Directives, the remainder of section 12.5.3. will consider the benefits arising from compliance and non-compliance from

¹⁹¹ The probability of the detriment includes considerations such as the difficulty in proving the causal nexus between the action and the damages incurred. Cf. Ogus, “Corrective taxes and financial impositions as regulatory instruments” (1998) *Modern Law Review*, p.780.

¹⁹² This model has been developed for criminal law and tort. Cf. Becker, “Crime and Punishment: An Economic Approach” (1968) *Journal of Political Economy*, p.169; Pyle, *The Economics and Law Enforcement* (1983).

¹⁹³ Diekmann, *Die Befolgung von Gesetzen* (1980), chapter II, para 3.2.

¹⁹⁴ PubSA#9, PubSA#10, BothSA#6, PubSA#3.

¹⁹⁵ PubSA#9.

the perspective of an outsider. The analysis of the benefits from an outsider viewpoint will be supported by insider accounts of practitioners.

12.5.3.1. Benefits from compliance

It seems plausible from an outsider perspective that rules are more likely to be complied with, if positive incentives are offered for compliance and they are known to actors. The latter must further perceive those incentives as sufficient to motivate a change in behaviour.¹⁹⁶

We have seen in section 3.2. that the possible benefits of regulated procurement are predominantly of macroeconomic nature. The opening up of national procurement markets and the re-structuring of national industries, two of the industrial and economic objectives of regulated procurement,¹⁹⁷ have no immediate positive impact on an individual procurement task. On the micro-economic level, authorities find it therefore probably difficult to perceive direct benefits arising from compliance. PubSA#11 endorsed this analysis by saying that savings achieved in PFI resulted from the development of this more efficient procurement method rather than from Community-wide competition.

An incentive for PFI awarding authorities to adhere to the rules could be that project lenders require warranties that the statutory obligations have been complied with. They are not prepared to take the risk that the SPV is exposed to a third party claim which is not accounted for, especially because it is not in the financial model. PrivSA#6 affirmatively remarked that ignoring the rules was not something lenders would readily turn a blind eye to. Especially in the case where the SPV became a utility within the meaning of the rules, as in the case of light rail projects, the lenders tended to act as a “policeman.”¹⁹⁸

¹⁹⁶ Opp, *Soziologie im Recht* (1973), pp.190-207.

¹⁹⁷ Arrowsmith, op.cit., note 9 of ch.1, p.236.

¹⁹⁸ PrivSA#6.

It is submitted from an outsider view that the lack of a micro-economic incentive to comply with a strict interpretation of the rules has detrimental effects on the impact of procurement law on the legal practice.

12.5.3.2. Benefits from non-compliance

Benefits arising from non-compliant or risky behaviour may result in additional detrimental effects on the impact of law which will be analysed in this section from an outsider perspective. We have seen that if the benefits from non-compliance (B) exceed the detriment (D) discounted by the probability of the sanction (p), deviance is beneficial to the addressee.

In PFI procurement, authorities balance the risks of being challenged on decisions adopted in the procurement process against potential benefits. One of the most pertinent procedural decisions is whether to employ the negotiated procedure in PFI. The competitive negotiated procedure provides authorities with the significant benefit of greater procedural flexibility. The department may reduce the number of bidders by assessing the merits of the proposals, conduct negotiations based on different specifications, and select a preferred bidder. In addition, the application of the negotiated procedure reduces the risk of being challenged by bidders for errors made in the more rigid restricted procedure. Further, it reduces the overall bidding costs for the tenderers.

On those grounds it is possible to conclude from an outsider perspective that authorities gain significant benefits (B) from employing the negotiated procedure although the derogations might not be satisfied in the given PFI project. In addition, as PubSA#10 pointed out, contractors prefer the negotiated procedure and therefore “we have never ever encountered a contractor who was wanting to make mischief” on this ground.

Due to the lack of commitment on the side of the bidders to enforce the rules and the patchy and rare enforcement actions taken by the Commission, the probability of being sanctioned (p) when not complying with procurement law appears low from an

outsider viewpoint.¹⁹⁹ Respondents to the empirical study endorsed this perception and said the probability of challenges was “negligible.”²⁰⁰ If it is accurate that the probability (p) of being challenged on procurement law is “negligible,” the deterrence (D) of procurement law is negligible too, because D is discounted by p.

Hence, with respect to this essential procedural issue, the significant benefits of non-compliance (B) exceed the negligible detriment (D) discounted by the low probability of sanction (p). From an outsider perspective it may be concluded that the procurement rules fail to deter its applicants from breaching the law. The conclusion that it is beneficial for authorities not to comply with procurement law has detrimental effects on the impact of the law in the books on the legal practice.

12.5.3.3. Findings

Procurement law does not seem to offer any perceptible benefits to contracting authorities, since international competition between contractors and the related savings for the authority have not yet materialised. Conversely, decisions that are either non-compliant or at least risky in view of procurement law provide authorities with tangible benefits such as procedural flexibility and a reduction in time and costs of the process. In viewing both aspects together, one can conclude from an outsider perspective that procurement law lacks incentives for authorities to comply. It is submitted that the lack of incentives significantly compromises the law's impact on the legal practice.

We have seen that the non-compliant or risky behaviour of authorities does not pose a significant risk of being challenged. It appears unlikely that this situation will change. Any changes would limit the discretion of authorities to conduct the procedure as they please and threaten the commercial viability of the deals. From a private sector angle, more rigid procedures would increase the bidding costs and bidders would be less able to present their tenders in negotiations. Hence, neither the

¹⁹⁹ This has been discussed above in section 12.5.2.

²⁰⁰ See section 12.5.

public sector authorities nor private sector contractors have an interest to change the PFI procurement practice.

Chapter 13 Conclusion

The aim of adopting an integrated perspective by combining insider and outsider perspective is to provide the study with a complete picture of PFI procurement practice. This section will summarise the findings for each perspective and will, finally, give a comprehensive analysis of the practice.

13.1. Analysis of the outsider perspective

We have seen that a functional concept of law underlies the outsider perspective to the legal practice. The concept of functionalism perceives norms as tools to accomplish specific tasks within society, especially to influence the behaviour of their addressees. In adopting an outsider perspective, it is possible to maintain that rules fulfil their function, if they change legally relevant behaviour of addressees. Under those circumstances, the law is described as having an “impact” on the behaviour of addressees.

Analysis from an outsider perspective leads to questions such as whether the law influenced the legally relevant behaviour of addressees. Chapter 12 has explored a selection of the most pertinent conditions for the law to make and to maximise its impact under the specific circumstances of PFI procurement. The following section will summarise whether those conditions are fulfilled and, consequently, whether procurement law has the intended impact on PFI procurement practice.

As explained in section 12.4.1.1., for the law to have a maximum impact, addressees should not accept competing rules and values. The divergence between the commercial requirements of PPP procurement practitioners and the non-amended procurement Directives has led to the adoption of competing norms, which provided practitioners with greater procedural flexibility. The competing rules accepted by practitioners alongside the Directives have been described as governmental guidance notes and PFI procurement practice which matured substantially over the years. We have seen that the latter may not always be compatible with the strict interpretation of

the procurement rules. On the other hand, it was suggested that the practice is compatible with the principles of non-discrimination and, to a large extent, competition. The compatibility with some of the principles underlying the Directives may suggest that PFI procurement practice does not deviate entirely from procurement law.

Section 12.4.1.2. has introduced another potentially relevant condition for law to be effective if it is based on supra-national E.C. Directives. It was assumed that Directives may have to be adequately implemented into national law to become fully effective. We have seen that the U.K. has implemented material procurement law properly in legal terms, and thus its potential non-implementation is not a factor influencing the law's impact on PFI procurement practice.

The second relevant pre-condition of law to effectively influence the legal practice is its diligent enforcement. It was discussed in section 12.5.1 that implementation of the Remedies Directives has been inadequate.¹

Sections 12.5.1.1. and 12.5.1.2. have shown bidders did not enforce the procurement Regulations in the national Courts as the European legislator envisaged it. This is mainly for the reason that bidders perceive actions enforcing a strict interpretation of procurement law as contravening their commercial interests. On the other hand, we have seen in section 12.5.2. that the Commission showed only recently the commitment to enforce its interpretation of the law using its powers granted by Article 226 E.C. Treaty. The inadequacies of both ways to enforce procurement law have substantially limited the law's impact in the PFI context.

Section 12.5.3. dealt with the third relevant condition for law to have an impact. It was submitted that addressees are incentivised to comply with a rule if the benefits arising from compliance outweigh possible detriments. Respondents maintained in

¹ On the requirement of an effective remedies system see: Pachnou, "Enforcement of the EC procurement rules: the standards required of national review systems under EC law in the context of the principle of effectiveness" (2000) *P.P.L.R.*, p.55.

section 12.5.3. that PFI awarding authorities constantly weighed the benefits and detriments of procedural decisions. They reached the conclusion that the detriments of strict compliance with procurement law outweighed the benefits by far. Especially the gains in procedural flexibility were said to be considerable. On the other hand, possible detriments in the form of bid challenges are negligible. The lack of incentives to comply with procurement law limited the law's impact on the PFI practice.

Section 12.4.1.3. described the consistent re-evaluation of the law as the fourth relevant condition for law to make an impact. We have seen that the impact of law was limited since the European legislator has chosen not to re-evaluate procurement law according to changes in its socio-economic context.

It can be concluded from the summary of the outsider perspective that all four relevant conditions for law to make an impact on the legal practice are not or not fully satisfied. The impact of procurement law on the practice can therefore only be described as limited. This means that in the context of PFI, procurement law was bereaved of the opportunity to influence legally relevant behaviour of its addressees in a substantial manner. From an outsider perspective and in having respect to the concept of functionalism underlying this perspective it is therefore possible to conclude that public procurement law is not entirely fulfilling its functions in the PFI context.

13.2. Analysis of the insider perspective

We have seen in section 4.1.7. that exploring the insider perspective of a legal practice involved in this project to invite participants to submit their subjective *meaning*, their interpretation, and their arguments with respect to legal uncertainties. The adoption of the insider perspective sought to gain their understanding of the role of public procurement law in PFI. The questions to be addressed included how lawyers bridged the gaps between the commercial requirements of PFI and the legal requirements of the Directives and how they assessed the risks involved.

Adopting the insider perspective has made it possible for this study to explain the reasons leading to the adoption of PFI procurement practice. Section 12.3.1. explored that, from the viewpoint of insiders, PFI procurement practice was developed because the commercial requirements diverged from the legal requirements of procurement law. Respondents remarked that the U.K. government actively supported this development not only by issuing guidance notes, but also by applying pressure on authorities to adhere with central government policy.

The legal advisors considered the practice to reflect a “commercial approach” which partly included the adoption of wide and risky interpretations of the procurement rules and partly clearly non-compliant behaviour. Lawyers justified the adoption of the lax approach with pragmatic and commercial considerations. They perceived the development of a flexible and commercially oriented PFI procurement practice as a natural reaction to an inadequate regulatory framework.

Asked for their perception of the impact of the rules on the practice, respondents generally concurred with the observation that PFI procurement practice was not compatible with a strict interpretation of procurement law. Practitioners felt they were victims of conflicting policies underlying European procurement law. While the law was enacted to reduce public purchasing costs, it stifles, on the other hand, the discretion of authorities to adopt more efficient procurement methods reducing public spending.

The more efficient procurement methods are a sign of significant changes in the commercial situation of public authorities. These changes have not been reflected in changes to the legal framework. It was mainly for this reason that practitioners perceived procurement law as an unnecessary burden placed on PFI and supported the development of PFI procurement practice.

We have seen in section 12.5.3. that authorities regularly assessed the risks arising from adopting decision in the procurement process. It was submitted that authorities could deviate from a strict interpretation of procurement law only because

bidders did not enforce the rules in the Courts. Authorities assessing the risk of being challenged could be confident that their non-compliant or risky behaviour would not be the subject of sanctions. This confidence was mainly based on the perception that an ineffective review system significantly reduced the risk for authorities to be challenged by bidders on decisions deviating from the letter of procurement law. Especially the costs of proceedings, which were described as “phenomenal,” were an effective impediment against employing the remedies.

Lawyers said that another obstacle against challenging authorities was the legal culture of the U.K. We have seen in section 12.5.1.3. that by using the term “legal culture,” they referred to a variety of aspects including the relative newness of the remedies system and the greater familiarity of U.K. lawyers with amicable settlement of disputes.

A further important reason to assess the risk of challenges as negligible was the commercial approach of U.K. bidders towards winning government contracts. Respondents argued that it was not in the commercial interest of bidders to launch challenges against government departments. According to their legal advisors, private sector firms perceived authorities as invaluable clients. Bidders seem prepared to accept adverse procurement decisions without casting too much doubt on the general fairness of the proceedings.

It is possible to conclude from those deliberations that the risks of being challenged by contractors were perceived as negligible. The balance between the risk of adopting a lax approach to procurement law and the benefits incurred by adopting a more pragmatic interpretation was therefore clearly in favour of the “commercial approach.”

13.3. Analysis of the integrated perspective

The study sought to adopt an integrated approach of looking at law suggesting that we should try to understand law from every angle possible. Viewing PFI procurement practice from two angles, the outsider and the insider perspective, has

provided us with a complete picture of the practice. Each view has made an integral contribution to the understanding of the practice and it was sought to treat them in a balanced manner.

It may be seen as one outcome of the study that insider and outsider perspective are naturally interwoven and that the two perspectives can be fruitfully combined when studying “living law.” In fact, the reliance on only one perspective, as suggested by insider or outsider perspective alone will almost certainly miss the opportunity to gain a complete picture of a social phenomenon.

In this study, the outsider perspective has enabled us to observe the development of the practice and, especially, the impact procurement law has on PFI procurement. On the other hand, the accounts of insiders have provided us with the opportunity to learn more about the motivation and understandings underlying their actions. The combination of both perspectives has led to the repeated contrast and comparison between the law in the books and the law in action, meaning the behaviour of the addressees of procurement law.

The complete picture of PFI procurement has increased the understanding about procurement law, its practical application, and its perception by addressees. Possible repercussions of the findings for procurement law have to be expressed in the form of questions rather than answers. Having reference to four relevant pre-conditions for procurement law making an impact on the legal practice prompts the question whether the law’s relevance should be increased in the context of complex procurement tasks.

This raises especially the question of whether procurement law should be re-evaluated in the light of the emergence of PPP projects. Is it still justified and necessary to bring PFIs under the full regulatory ambit of the Directives? Are less invasive means of regulation conceivable for the procurement process of complex contracts? Would the introduction of those means increase the acceptance of the law in the books? Should the rules be dragged to the practice, as demanded by PrivSA#1,

or does the Commission rightly insist on strict compliance with the letter of the existing law?

If the rules are held worthwhile to be maintained in their current form, the question has to be raised whether the procurement remedies should be made more accessible and their use more attractive for bidders. Is it conceivable to remedy concerns of bidders related to the possible misconduct of procurement proceedings in a swift and inexpensive way?

The aim of this study has been to increase the understanding of procurement law and its practical application in the context of PPPs and PFIs. It is submitted that such increased understanding of the law is a necessary requirement of positive change.

1. Introduction/ Expert Status

- Q1a** *In which PFI sectors have you personally advised contracting authorities?*
- Q1b** *When you are advising your public sector clients on the implementation of PFI projects, do they following your advice?*
- Q1c** *When we talk about the relationship between the regulatory regime governing public procurement and PFI, which particular concerns instantly spring to your mind as a result of your experience?*
- Q1d** *Some of your colleagues argue that the procurement rules are fundamentally incompatible with the commercial necessities of PFI procurement; do you agree?*
 If yes: *Why?*
 If no: *Why not?*

2. Choice of Procedure

- Q2a** *The overwhelming number of PFI projects was delivered by using the negotiated procedure; which procedure do you normally choose to award PFI contracts?*
- Q2b** *What considerations influence your decision on which procedure should be employed in a PFI?*
- Q2c** *The directives provide certain derogations for using the competitive negotiated procedure; on which grounds have you employed it?*
- “Overall pricing is not possible”
 - “Specification cannot be drawn up with sufficient precision”
 - Other ground
- Q2d** *Many PFI practitioners argue (with the Treasury) that PFI projects will regularly come under the umbrella of the “overall pricing” derogation, since it is often impossible for the authority to predict in advance what amounts the tenderers will bid; how do you interpret the terms “overall pricing” and “is not possible”?*
According to the wording of the directives, the “overall pricing” derogation may only be employed in “exceptional” circumstances. What importance did you attach to the “exceptionality” of the “overall pricing” derogation when compared with other derogations?
Why?
Did you consider using other derogations alternatively?
- Q2e** *The other derogation often employed in PFI projects allows the use of the competitive negotiated procedure if “specifications cannot be drawn up with*

sufficient precision”. From your point of view, in which cases is it possible to employ this exemption?

How do you interpret “sufficient precision”?

Q2f *In the light of the current trend towards standardisation of PFI contracts it is suggested to advertise and deliver PFIs in applying the restricted procedure. Do you think that this suggestion is viable?*

Q2g *Some authors argue that if one applies a strict interpretation to the procurement rules, it will be hardly feasible to employ the negotiated procedure in PFI procurement. Considering this approach, do you and your clients consider the risk of being challenged when opting for the negotiated procedure?*

If no: Q2i

If yes: By whom?

Q2h *Did you rely on Treasury guidance notes when assessing the risks involved? Was the litigation risk commercially balanced against benefits arising from adopting this decision, such as a reduced time and costs to negotiate the contract?*

If yes: Was the litigation risk commercially balanced against incurring benefits when adopting other procedural decisions?

Which?

If no: Don’t ask the “balancing” question again in the context of the other procedural problems.

If yes: If you balanced the risk, what considerations were taken into account?

Q2i *Apart from aggrieved bidders, the European Commission may challenge any behaviour thought to be deviating from the E.U. Law by embarking on an Article 226 (ex 169) procedure against the U.K.. Did you and your clients consider the possibility that the Commission could embark on such a procedure?*

Q2j *Have you ever given your advice on a project which was partly funded by the European Community?*

If no: Q2k

If yes: Did you consider the possibility that the Commission might withdraw the funds in case of any irregularities in the procurement process?

Q2k *On the continent, contracting authorities currently face a wave of litigation. What consideration did you and your clients give to the assumption that continental bidders tendering for contracts in the U.K. are probably more likely to utilise the remedy system than U.K. contractors?*

If so: How did it effect your decision-making process?

Q2l *Is this Situation is likely to change after the Harmon case?*

3. *Drafting step-in Rights*

- Q3a** *Another grey area of PFI procurement is the question of how to draft step-in rights for the project lenders. Normally, the authority will enter into a "direct agreement" with the major subcontractors and the person providing finance to the consortium. Typically, such a tripartite agreement will allow the financier "step-in rights" to intervene where the contractor becomes insolvent or seems unlikely to meet his obligations to the authority or the financier. The direct agreement generally allows the authority to veto the proposed new contractor or sub-contractor, but only on limited grounds set out in the agreement. Many authorities include veto grounds such as national security and secrecy; what veto grounds do you normally include into the contract?*
- Q3b** *It is suggested in the literature to restrict the authority's veto to grounds which are contemplated by the procurement Regulations, such as financial and technical standing of the new (sub-) contractor; what do you think about this suggestion?*
Is it viable?
Did you consider this possibility?

4. *Classification of the contract as Concession/ Utility*

- Q4a** *Have you encountered the situation where a PFI project could have been classified as a concession contract?*
If no: Q5a
If yes: Q4b
- Q4b** *The procurement rules cover only contracts for works concessions. Did you consider that one of the contracts you have given legal advice on could have been a service concession and thus falling completely outside the procurement rules?*
- Q4c** *Where payment is received from public users or from the government and the public users, PFI contracts contain concession elements. In your view, what proportion of the project income must derive from the exploitation of the asset to classify the whole project as concession contract?*
- Q4d** *The H.M. Treasury suggests that a contract can be classified as concession contract, if at least 15-20% of the income stream derives from the "exploitation" element. This interpretation exempts many contracts from applying the full procurement regime.*
Which threshold did you apply?
Did you consider the risks of being challenged on this decision?
- Q4f** *Did you and your clients consider the possibility of being challenged by firms when deciding that the project has to be classified as concession?*
If no: Q4g

If yes: *Did you rely on Treasury guidance notes when assessing the risks involved?*

Q4g *Was the litigation risk commercially balanced against the various benefits arising from the classification of the contract as concession?*

If no: **Q4h**

If yes: *If you balanced the risk, what considerations were taken into account?*

Did you and your clients acknowledge that continental bidders are probably

more likely to utilise the U.K. remedy system than U.K. contractors?

Q4h *Apart from aggrieved bidders, the European Commission may challenge any behaviour thought to be deviating from the E.U. Law by embarking on an Article 226 (ex 169) procedure. Was this consideration taken into account when classifying the contract as concession?*

Q4h *Do you have experience in delivering PFIs in the Utilities sector, such as lightrail or waste-to-energy projects?*

If no: **Q5a**

If yes: *Did you encounter any specific problems?*

Did you and your clients consider that the project company may be obliged to advertise its sub-contracts under the Utilities Regs?

5. Use of Selection, Shortlisting and Award Criteria

Q5a *What sources influence your choice of the selection, shortlisting or award criteria applied?*

Treasury guidance notes?

If so: *Were those favoured over the Directives?*

Own experience?

If so: *Which sources influenced the experience gained in earlier projects?*

Procurement Directives?

Treasury Guidance?

Q5b *Which criteria do you normally suggest authorities to employ to*

a. select and shortlist tenderers and

b. to award the contract?

c. Did you use one of the following criteria?

- Ability and willingness to form a good working relationship

- Acceptance of standardised contract terms

- Development of PFI industries

- Acceptance of the bidders by members of staff in staff consultations

Q5c *Did it occur in one of the PFI projects you have given your advice on that the contracting authority was inclined to change the award criteria in*

response to the proposals submitted by bidders?*Possible conditions for changes to the assessment criteria:*

- *changes are notified to the bidders*
- *firms are given sufficient time to adjust their bids*
- *changes are not material*

Q5d *Did you and your clients consider the possibility of being challenged by firms when choosing/ changing the shortlisting and award criteria?*

If no: Q5e

If yes: Did you rely on Treasury guidance notes when assessing the risks involved?

Q5e *Was the litigation risk commercially balanced against the benefits from choosing/changing specific selection/ award criteria?*

If no: cool down question

If yes: If you balanced the risk, what considerations were taken into account?

Did you and your clients acknowledge that continental bidders are probably more likely to utilise the U.K. remedy system than U.K. contractors?

6. “Cool down” question

CD1 *If you had the chance to amend the procurement directives, what would you change or alter?*

CD2 *Now that you know my research, is there anything that I should have asked but did not?*

Private Sector Advisors

#1 Private Sector Advisor

City law firm, defence, health and recent experience in local government

#2 Private Sector Advisor

Regional law firm, transport, defence

#3 Private Sector Advisor

City law firm, health, education, local government, defence

#4 Private Sector Advisor

City law firm, transport, prisons, defence, government accommodation

#5 Private Sector Advisor

City law firm, prisons, roads, transport, London Underground

#6 Private Sector Advisor

City law firm, transport, prisons, defence, government accommodation, health sector

Public Sector Advisors

#1 Public Sector Advisor

City law firm, government accommodation, health, utility projects

#2 Public Sector Advisor

City law firm, health, local government

#3 Public Sector Advisor

Regional law firm, local government, health sector, defence

#4 Public Sector Advisor

Regional law firm, local government, health sector

#5 Public Sector Advisor

City law firm, transport, prisons, defence, government accommodation

#6 Public Sector Advisor

City law firm, IT, defence

#7 Public Sector Advisor

Regional law firm, defence, government accommodation, health, local government, utility projects

#8 Public Sector Advisor

Regional law firm, health, sewage and water, defence, government accommodation, local government, education, IT, some private sector experience

#9 Public Sector Advisor

City law firm, health, education, local governments, some private sector experience

#10 Public Sector Advisor

Regional law firm, local government, education, housing

#11 Public Sector Advisor

Regional law firm, local government, health sector, education

#12 Public Sector Advisor

City law firm, IT, transport, prisons, defence

Advisors with experience in both sectors

#1 Advisor to both Sectors

City law firm, transport, Utility projects

#2 Advisor to both Sectors

City law firm, utility projects, prisons, DBFO roads, London Underground, health, advised banks

#3 Advisor to both Sectors

Regional law firm, health, education, accommodation, IT, housing

#4 Advisor to both Sectors

Brussels office of a city law firm, health, transport, utility projects

#5 Advisor to both Sectors

Brussels office of a city law firm, utility projects, transport

#6 Advisor to both Sectors

Brussels office of a city law firm, health, defence, utility projects